U.S. Department of the Interior
Office of Inspector General

# Evaluation Report

# Working Capital Fund

No. 2003-I-0056

*Photos Courtesy of Microsoft Clip Art Gallery*

June 2003

United States Department of the Interior
Office of Inspector General
Eastern Region Audits
381 Elden Street
Suite 1100
Herndon, Virginia 20170

June 16, 2003

Memorandum

To: Assistant Secretary for Policy, Management and Budget

From: William J. Dolan, Jr. *William J. Dolan, Jr.*
Regional Audit Manager, Eastern Region

Subject: Final Evaluation Report on the Department of the Interior Working Capital Fund (No. 2003-I-0056)

This report presents the results of our evaluation of the Department of the Interior's Working Capital Fund (WCF) program activity. We performed the evaluation at the request of the Committee on Appropriations, Subcommittee on Interior and Related Agencies.

The Department uses the WCF to provide common administrative services to Bureaus and offices within the Department and to other federal agencies. Our main findings were that the WCF had accumulated a $20 million surplus as of September 30, 2001, had not established authorized reserves, and had deficiencies in its billing process. The Department needs to determine the amounts necessary to fund authorized reserves and could use a portion of the surplus for this purpose.

In the May 30, 2003, response to our draft report, the Assistant Secretary for Policy, Management and Budget concurred with the report's nine recommendations. However, the response did not provide sufficient information for us to consider recommendation 6 resolved. Accordingly, we request that you provide the additional information requested in Appendix 4. Please provide a response to Mr. Roger LaRouche, Assistant Inspector General for Audits, (MS 5341-MIB) by July 18, 2003.

The legislation, as amended, creating the Office of Inspector General, (5 U.S.C. App. 3) requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation exhibited by the WCF staff and compliment them for taking timely actions to address the issues brought to their attention during our review. If you have any questions regarding this report, please contact me at (703) 487-8011.

cc: Audit Liaison Officer, National Business Center

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# Executive Summary

## Department of the Interior Working Capital Fund

The Department of the Interior (DOI or Department) established the Working Capital Fund (WCF) in 1950 to finance common support services – such as accounting and contracting – for the Department and its bureaus and offices, as well as other federal departments and agencies. The fund is replenished through billing these federal entities for services provided.

The WCF finances the operations of the National Business Center (NBC), which provides products and services; the Office of Aircraft Services (OAS), which operates all aircraft activities; and other DOI management activities such as the Office of the Chief Information Officer, which are provided by the Departmental offices.

In an attempt to standardize procedures and simplify operations, the Department merged three of its service centers into the NBC in 1999. During our evaluation, however, we found that NBC continues to operate as three separate components with some of its original redundancies.

Other concerns disclosed by our evaluation are summarized below:

- The WCF accumulated a $20 million surplus as of September 30, 2001. Key WCF officials were unaware of this surplus prior to our evaluation.
- The NBC planned to increase prices to fund six reserves, four of which we believe are not authorized. In addition, the planned price increases did not consider the $20 million surplus.
- WCF financial data did not provide enough information to determine whether specific product lines were making or losing money.
- The WCF was used to fund activities provided by offices that also received direct appropriations.

- The WCF did not provide sufficient information to customers to facilitate budgeting.

We did find, however, that credit card rebates, which are collected and managed through the WCF, were used for authorized activities in accordance with legislative intent.

We made nine recommendations to improve departmental management and the National Business Center Working Capital Fund operations.

# Contents

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# Introduction

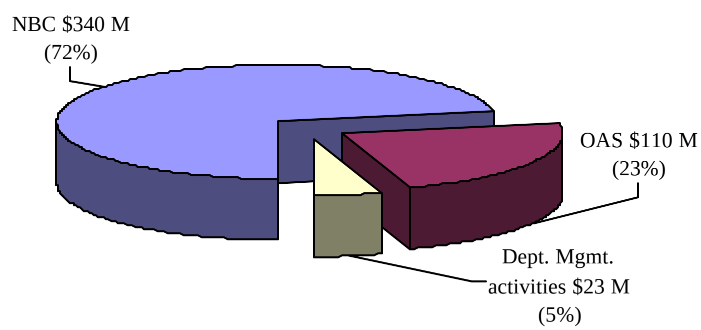
## Background

The Working Capital Fund (WCF) was created[1] to provide common administrative and support services efficiently and economically at cost to the bureaus and offices of the Department of the Interior (DOI) and other Federal agencies. The WCF is a revolving fund, which is replenished by revenues received from customers who are billed for the costs of services provided.

The WCF finances the operation of the National Business Center (NBC), which provides products and services; the Office of Aircraft Services (OAS)[2], which operates all aircraft activities; and departmental management activities, which are provided by the Departmental offices. The NBC was formed in fiscal year (FY) 1999 with the merger of the Interior Service Center, located in Washington, D.C.; the Washington Administrative Service Center, located in Reston, VA; and the Denver Administrative Service Center, located in Denver, CO. The NBC is the principal service provider, offering 28 products and services to its customers (see Appendix 1).

As shown in Figure 1, estimated revenue for the WCF for FY 2002 was $473 million, 72 percent from NBC services, 23 percent from OAS, and 5 percent from departmental management activities.

**Figure 1 - WCF Estimated FY 2002 Revenue**




[1] 43 U.S.C. § 1467 authorized the creation of the working capital fund in the Department of the Interior.

[2] OAS merged with the NBC in FY 2002.

The original authorizing legislation limited the WCF to performing work and accepting payment from only Federal sources. In FY 2000, however, the DOI was authorized to retain rebates earned through its purchase card program. This authority became permanent in FY 2001. These rebates, estimated at $6 million for FY 2002, were deposited into the WCF to fund administrative management projects of general benefit to the DOI's bureaus and offices. These projects were evaluated and prioritized in consultation with the DOI's Management Initiative Team[3], which earmarks the funds for the highest priority projects. Also, in FY 2001, the WCF was authorized to rent meeting space within the Main Interior Complex to the private sector.

## Objective and Scope

The objective of our evaluation was to determine whether the WCF charged DOI entities and other government agencies equitably and consistently. We also wanted to determine whether customers were provided with sufficient information to plan and budget for WCF charges; whether WCF charges were used for allowable activities; and whether credit card rebates were used appropriately.

The scope of our evaluation included a review of WCF procedures for establishing written policies and procedures, including performance goals and measures for fiscal years 2001 and 2002. The Office of Aircraft Services (OAS) was excluded from our review because the General Accounting Office recently conducted an audit of the OAS and issued a report in April 2002.

The methodology of our evaluation and prior audit/evaluation coverage are detailed in Appendix 2.

[3] The Management Initiative Team is made up of representatives from each DOI bureau. Its role is to recommend projects to be funded with bank card rebates to the Assistant Secretary for Policy, Management and Budget.

# Results of Evaluation

Improvements are needed in the administration of the WCF. Specifically, we found that:

- Key WCF officials were unaware of an accumulated $20 million surplus as of September 30, 2001.

- The WCF did not establish authorized reserves for accumulated annual leave and equipment replacement. Furthermore, the NBC planned to implement four other reserves within the WCF, which we believe are not authorized, and then planned to raise prices to fund all six reserves.

- The WCF was used to fund activities provided by offices that also received direct appropriations.

- The WCF did not provide a sufficient level of transparency in supplying information to customers.

Despite these weaknesses, the WCF appropriately charged customers for allowable activities such as budget, procurement, personnel management, finance, and accounting services. In addition, the WCF's exceptional operation of the bankcard rebate program maximized purchase card rebates awarded to the Department. As a result, the WCF collected $6 million in rebates used to fund activities such as diversity initiatives and information technology security.

## Surplus of $20 Million

The WCF had accumulated a $20 million surplus as of September 30, 2001. WCF officials were unaware of this surplus prior to our evaluation. An analysis shows that approximately $17 million of the surplus was accumulated prior to the organizational merger in 1999, and an additional $3 million was accumulated in FYs 2000 and 2001. Since the WCF tracks revenue and expenses by billing type, we found that DOI bureaus accounted for approximately $14 million, or 70 percent, of the $20 million surplus. DOI officials were unable to provide an explanation or analysis of the surplus. In the absence of any other credible explanation afforded by the Department, we believe that charging customers for more than the cost of delivering services may have been the principle cause of the surplus. We also found instances where customers were charged less than the cost of delivering services. We attribute this overcharging and undercharging to an accounting system that cannot track costs and revenues by products and services and the lack of a standard billing process.

***Accurate cost information on business lines lacking***

The WCF uses the Department's Federal Financial System (FFS) to record its revenue and expenses. Although the FFS contains data to track revenue and expenses by billing type, it does not contain detailed data to do the same by products and services. Lacking accurate cost information on its business lines, the WCF cannot identify which of its products and services are losing money and, therefore, cannot determine whether to increase prices or eliminate products and services. A report prepared for management by the WCF's Cost Accounting Team stated that "the current accounting structure, current accounting application, and current procedures for recording employee time and attendance would not be adequate to support Activity Based Costing." Management recognizes these weaknesses in the accounting system and will need to address them before implementing an Activity Based Costing system.

***Standardized Billing Process Needed***

The WCF does not have a standardized billing process. Although the WCF merged its service centers in 1999, it continues to function as three separate organizations using three separate billing methods:

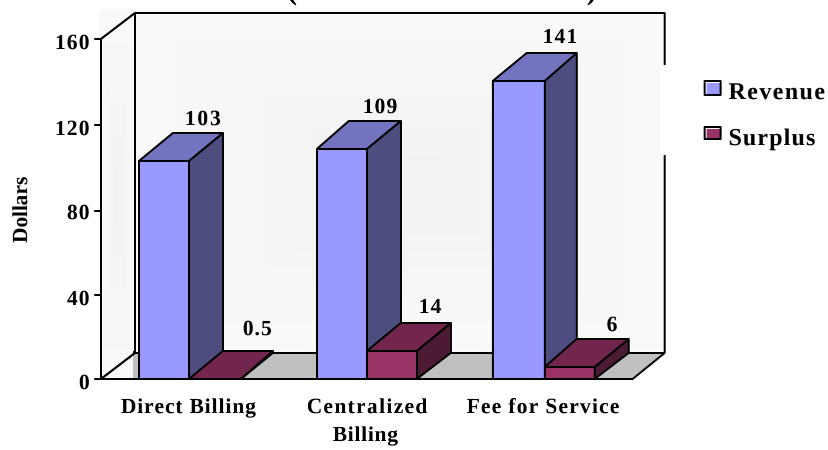
- Direct Billing - Services, such as printing orders, are billed through a time and materials reimbursable support agreement. This method is used to bill customers outside the department.

- Centralized Billing - Services, such as building security, are billed at fixed prices. This method is used to bill DOI customers.

- Fee for Service - Services are billed at pre-established unit costs. For example, payroll is billed on a price per W-2. This method is used to bill DOI customers and customers outside of the department.

Although revenue from direct billing (customers outside the department) was similar to revenue from centralized billing (DOI customers), DOI customers paid the majority of the surplus, as shown in Figure 2.

**Figure 2 - Revenue and Surplus by Billing Type For 2001 (in millions rounded)**




We determined that the billing method used to charge DOI customers is based on estimates that are adjusted infrequently, whereas bills sent to customers outside the department are more closely related to actual costs.

In addition to using three different billing methods, the WCF is inconsistent in recovering administrative costs. Some billings did not include a charge for administrative costs, others charged a predetermined amount for administration, and still others used an administrative (indirect cost) rate. In cases where a rate was used, the WCF could not determine whether the rate effectively recovered administrative costs.

These problems occurred because the WCF had not developed and implemented a single set of policies and procedures for billing customers and recovering administrative costs. Examples of billing errors noted during our review include:

- The WCF charged mail and messenger services to the Advisory Council for Historic Preservation in the Main Interior Building in FY 2002. Although the Council had occupied space in the Main Interior Building at one time, it had moved its offices to another location during FY 2001.

- The WCF charged DOI bureaus and offices differently than external clients for its drug-testing program. The WCF charged its external clients an administrative fee that it did not charge the DOI bureaus.

- The WCF charged only DOI bureaus and offices for the costs of updating a financial accounting system problem. These costs should have been charged equally to all WCF customers that benefited from the updated system.

- The WCF charged customers for automated data processing based on outdated usage information.

## Reserves

The WCF had not established authorized[4] reserves for accrued annual leave and equipment replacement. Instead, the WCF financed these costs through current operations. During the evaluation, WCF officials informed us that they planned to establish six reserves - the two specifically authorized by legislation and four others for research and development, capital investment, contingencies, and shut down. To finance the six reserves, the WCF plans to increase prices to its customers by $38 million over a 5-year period.

***Planned reserves not authorized***

In response to our concerns about the four additional reserves, WCF officials obtained an opinion from the Office of the Solicitor (SOL). The SOL opined that reserves were not limited to those specifically identified in the authorizing legislation for accrued annual leave and depreciation of equipment, but also may encompass other reserves. The OIG Office of General Counsel (OGC) disagreed with the SOL analysis. OGC found the purpose of the fund and those reserves that may be collected by the WCF are restricted by the precise language found in 43 U.S.C.§§ 1467 and 1468.

We contacted the Departments of the Treasury, State, and Justice to inquire about the reserves they established for their working capital fund operations. These agencies either established reserves only for costs that are specifically authorized by legislation, or they annually funded the costs

[4] 43 U.S.C. § 1467 states that the "fund shall be reimbursed from available funds of bureaus, offices, and agencies for which services are performed at rates which will return in full all expenses of operation, including reserves for accrued annual leave and depreciation of equipment."

through current operations. The results of our inquiries are summarized below:

- The Department of the Treasury is authorized to establish reserves for accrued annual leave and depreciation of plant and equipment. It has not, however, established any reserves for these items and recovers these costs through current operations. Also, excess revenues over expenditures (surplus) are returned to their customers.

- The Department of State is authorized to establish reserves for accrued annual leave and depreciation of plant and equipment. However, the Department of State funds these costs through current operations. If the fund collects too much money, it reduces the rates charged for services in the succeeding year.

- The Department of Justice is authorized and has established reserves for depreciation of plant and equipment, improvement and implementation of the Department's financial management and payroll/personnel systems, and development and implementation of law enforcement or litigation related automated data processing systems.

We believe that the WCF should (1) establish reserves only for accrued annual leave and equipment replacement, as authorized, (2) determine the amounts necessary to fund each reserve, and (3) fund the authorized reserves with part of its $20 million surplus before considering price increases.

## Bureau Charges

The WCF charged the bureaus $12 million for departmental management activities. These charges, which are separate from the NBC, were in addition to $71 million appropriated by the Congress. We raise this issue because it appears to conflict with appropriation language, which states that "no programs funded with appropriated funds in the Departmental Management … may be augmented through the Working Capital Fund or the Consolidated Working Fund."

Based on our review of budget justifications, we were able to identify charges of $8.5 million to bureaus and offices for specific activities that were also funded by direct appropriations of $8.8 million to Departmental management, as follows:

| | Amounts (In Millions) | |
|---|---|---|
| Activity | Appropriation | Charges |
| Office of the CIO | $2.9 | $5.5 |
| Risk & Public Safety | 1.4 | 1.5 |
| Planning and Performance | .4 | .7 |
| Office of Communication | 1.2 | .7 |
| Office of Financial Mgt. | 2.9 | .1 |
| Totals | $8.8 | $8.5 |

***Method of funding Departmental Management needs clarification***

DOI management officials believe that there is a distinction between the funding of policy and oversight [Department management] versus funding activities which are operational in nature. They also believe these factors are clearly disclosed in the budget justifications for Departmental Management and the WCF. They further advised that "in all likelihood, such services have existed since the inception of the fund in the 1950s." Additionally, we were told that this method of funding was presented "with the [Appropriations] Committee's concurrence" in the 1997 budget justification, in conjunction with a reorganization of WCF activities. The WCF, however, was unable to provide documentation to support this position.

We do not believe the information is clearly disclosed in the budget justification. For example, we reviewed the FY 2002 budget amounts pertaining to the program activities for the CIO contained in the FY 2003 budget justification for Departmental Management. The budget justification identified a direct appropriation of $2.9 million. It does not identify an additional $5.5 million, which the CIO will receive through WCF charges to the bureaus and offices.

The budget for the WCF is presented 80 pages after the budget for the CIO and identifies activities, amounts, and full time equivalent (FTE) positions funded through the WCF for NBC, other WCF activities, and OAS. For the other WCF activities, there are 18 individual activities totaling approximately $12 million. Some of the activities clearly related to information technology (IT), such as IT security and IT initiatives. However, the narrative descriptions of these and the other activities do not specify that any of them will be used to finance the operations of the CIO. To identify the $5.5 million, one would have to determine which of the 18 activities (we later found that there are six) were funding the CIO.

We believe that DOI officials should discuss this method of funding with the House and Senate Subcommittees on Appropriations for Interior and Related Agencies to ensure that all parties are clearly aware of how activities are funded and clarify future budget justifications.

## Information to DOI Customers

The WCF does not provide a comprehensive report that identifies which services are mandatory or optional, the amount of the services being provided, or the methodology used to charge the bureaus. The billings described only general categories and did not provide explanations for adjustments to initial cost estimates. For example, the Management and Technical Services Division is listed as a single line item in the WCF centralized billing. We determined that this line item is actually charged as an administrative cost and consists of the Division Chief and Secretary, Planning and Performance Branch, Facilities Group, Logistics, Mail Room Group, and MSD Support Services.

In another example, the centralized billing included a line item for Capital Planning without any description. In response to our inquiry, WCF officials provided a document that states, "To comply with the Clinger-Cohen Act of 1996, the agency must maintain a robust Information Technology Capital Planning and Investment Control program." This does not describe to customers, however, what services they receive under Capital Planning.

Further, there was no distinction between optional and mandatory services. As a result, the bureaus and offices could not make informed decisions regarding the nature of services available to them or determine whether or not they used or needed the services for which they were billed.

The bureaus use the WCF's budget estimates to request appropriated funds. If these estimates do not accurately represent future costs, the bureaus must fund the difference with funds allocated for other activities. For example, in FY 2003, the WCF billed three DOI bureaus an additional $2.2 million over original estimates: the Office of the Secretary, $880,000; the National Park Service, $690,000; and the Bureau of Land Management, $614,000. In order to compensate for this increase, the bureaus used funds allocated for other activities. These increases have created skepticism and concern among the bureaus as to whether the WCF charges fairly. As a result of our concerns, the Deputy Assistant Secretary for Budget initiated monthly meetings with DOI bureaus and offices to promote a new level of transparency.

## Authorized Activities and Credit Card Rebates

We did not identify any instances where the WCF charged bureaus and offices for activities that were not authorized. The WCF charged customers for allowable activities such as budget, procurement, personnel management, finance, and accounting. In addition, the WCF's operation of the bankcard rebate program maximized purchase card rebates awarded to the Department. We found that the credit card rebates were used for the general benefit of the bureaus. Credit card rebates were $6 million for FY 2001 and are expected to be $6 million for FY 2002. Projects funded from credit card rebates include diversity initiatives, payroll enhancements, audit support, and IT security.

# Recommendations

To improve the WCF, we recommend that the Assistant Secretary for Policy, Management and Budget:

1. Implement a cost accounting system to track costs and revenues by product line.

2. Develop and implement written policies and procedures regarding recovery of costs by product lines to prevent over and under charging of customers.

3. Establish equitable administrative cost rates.

4. Establish reserves only as specified in authorizing legislation. After appropriate financial analysis, set limits for the reserves.

5. Fund authorized reserves with existing surplus.

6. Discuss with the House and Senate Subcommittees on Appropriations for Interior and Related Agencies the current method of funding for and the clear disclosure of Departmental management activities in the budget justifications.

7. Use current data to provide customers with the most accurate information available.

8. Provide the bureaus with a list of services that are mandatory and those that are optional.

9. Provide a detailed explanation to the bureaus and offices when original billings are revised. At a minimum, the explanation should include a justification for the revision and a description of additional services or enhancements to be provided.

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# Office of Assistant Secretary, Policy, Management and Budget Response and Office of Inspector General Reply

The May 30, 2003, response (Appendix 3) generally agreed with the nine recommendations. The response also included suggested changes to the report and additional information that we considered and included as appropriate. Although we included many of the suggested changes recommended by the response, there were three substantial changes that we did not make. These changes addressed the use of the term "surplus," the establishment of reserves, and billing methods. The Assistant Secretary's comments in these areas and our replies are summarized below.

**Assistant Secretary's Comment**

**Surplus**

The response disagreed with our use of the term "surplus," requesting we delete the words entirely from the body of the report and Recommendation 5 and replace the term with "cumulative results of operations." The response stated that surplus implies that the WCF contains cash in excess of the Department's needs. In support of its position, the response stated:

> . . . the report fails to mention that the audited financial statement indicates that nearly $17 million has been identified for equipment depreciation and replacement. . . . Second, the $20 million "surplus" reported in the study only includes four sub-accounts which have positive values and did not consider the overall impact that a possible reduction in resources might have on the entire fund. . . . Finally, the report, of necessity, is based on funding levels reported at a given point in time. Most of the data in the report is based on FY [fiscal year] 2001 end of year data, yet we are today operating in the eight month of FY 2003, some 20 months later.

**Office of Inspector General Reply**

Describing the $20 million as a surplus is appropriate, notwithstanding that our calculation of the amount was based on an analysis of the WCF's fiscal year 2001 reported cumulative results of operations. The WCF's reported cumulative results of operations for fiscal year 2001 totaled approximately $80 million. We reduced the $80 million by amounts reported for unfunded liabilities (accrued annual leave) and for property, plant and equipment, which left a balance of $36.5 million. This amount represents the excess of revenue over expenses that had accumulated since inception of the WCF. We made further reductions related to revenues attributable to the credit card rebate program ($7 million) and to the Office of Aircraft Services ($12 million). Finally, we added $2.1 million, representing excess WCF revenues over expenses for fiscal 2001, to the $17.5 million balance. Calling this adjusted amount cumulative results of operations would be inaccurate because the $20 million surplus is attributed to only excess revenues over expenditures, whereas cumulative results of operations would additionally include unfunded liabilities and the capitalized value of equipment less depreciation.

We did not reduce the $20 million by reported accumulated depreciation[5] (approximately $14 million for fiscal year 2001) because accumulated depreciation does not directly relate to future equipment replacement needs. The $14 million represents equipment costs that have been expensed in the current and prior years and has little relationship to the amount that should be established as a reserve. The NBC did not provide us with any information or analysis on future equipment replacement needs. Equating accumulated depreciation to a reserve for equipment replacement is unrealistic because all capitalized equipment is depreciated, whereas, only some of the equipment will be replaced in a given year. A reserve for annual equipment replacement would be a much lesser amount. Further, the WCF was paying for annual equipment replacement with funds recovered through customer billings.

Regarding the comment that our study included "only four sub-accounts which have positive values," we disagree. Our analysis considered all funds that had a balance whether positive or negative.

In regard to the period covered by our analysis, we used the most recent audited financial data (fiscal year 2001) that was available at the time of our review. Subsequent to the completion of our analysis, the Department issued its annual financial report for fiscal year 2002. Our review of audited financial data in the 2002 report notes that the WCF had

[5] The accumulated depreciation account is used to accumulate the depreciation to date for all capital assets less those that were sold, traded or scrapped.

accumulated an additional $2 million of excess revenue over expenditures.

## Assistant Secretary's Comment

**Establishment of Reserves**

The response suggested we revise the report statement (page 6), "The WCF had not established authorized reserves for accrued annual leave and equipment replacement." The response suggested we state, "WCF managers had not established an auditable process for reserves for equipment replacement." The response noted that accrued annual leave is a liability of the WCF and has already been taken into account when arriving at cumulative results of operations. To reserve any additional cash for this would constitute double counting. It is an auditable process for legally allowed capital replacement reserves that is the missing piece.

## Office of Inspector General Reply

At the time of our review, the WCF had not established reserves for accrued annual leave or equipment replacement because they were paid from current operations on an as needed basis. There was not an auditable process because the WCF had not established any reserve accounts. In fact, before we identified the $20 million, WCF officials informed us that they had not established any reserves for accumulated annual leave or equipment replacement.

We agree with the Assistant Secretary's response, that if the accrued annual leave liability is to be used as the reserve amount, a separate reserve should not be established. However, this policy needs to be established and disclosed in the financial statements because we were unable to identify that accrued annual leave liability was included in the WCF's balance sheet for FY 2001 and FY 2002.

If the WCF decides to fund equipment replacement through a reserve, an analysis would need to be performed to determine the cost of equipment that needs to be replaced. The WCF would then need to identify this amount as a reserve in the financial statements. The WCF should not use the accumulated depreciation amount included in the financial statements because it is an inflated amount that includes fully depreciated equipment still being used and equipment that will not be replaced until future years.

## Assistant Secretary's Comment

**Billing Methods**

The response requested that we delete the statement and related figure on page 5 of the report, "Although revenue from direct billing (customers outside the Department) was similar to revenue from centralized billing (DOI customers), DOI customers paid the majority of the surplus, as shown in figure 2." The response stated that the revenue and expense by fund should be considered non-severable, especially for the four funds in this analysis. Therefore, cumulative results of operations should not be considered separately.

## Office of Inspector General Reply

We disagree with deleting the sentence as requested. We believe that the three billing methods should be shown separately to demonstrate that there is a problem with the centralized billing method. The statement in the report and related graph clearly show that payments made by DOI customers represent the majority of the surplus. As stated previously, cumulative results of operations are comprised of a number of items. This statement in the report concerns the portion of the cumulative results of operations that represents excess revenues over expenditures.

p

**Appendix 1**

# NBC Products and Services

| | |
|---|---|
| ➢ Accounting Operations<br>➢ Acquisition Services<br>➢ ADP Services<br>➢ Business Opportunities<br>➢ Contract Administration<br>➢ Creative Communication Services<br>➢ DOI University<br>➢ Drug & Alcohol Testing<br>➢ Electronic Commerce<br>➢ Employee & Public Services<br>➢ Enhanced Fixed Assets<br>➢ Performance Support Services<br>➢ Procurement Systems<br>➢ Quarters Programs | ➢ Executive Information Services<br>➢ FHRIS<br>➢ Federal Financial System<br>➢ Federal Payroll System<br>➢ FPPS 2000<br>➢ Fiscal Services<br>➢ Hyperion Enterprise<br>➢ Independent Validation & Verification Services<br>➢ Legacy Plus<br>➢ Momentum<br>➢ Organization Development<br>➢ T&A System<br>➢ Travel Manager<br>➢ Web Development & Hosting |

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# Methodology and Prior Audit Coverage

## Methodology

Our evaluation was conducted in accordance with the President's Council on Integrity and Efficiency's Quality Standards for Inspections. Accordingly, we conducted tests or reviews of records that we considered necessary under the circumstances. We evaluated the internal controls over the WCF's administration and operation and found significant weaknesses relating to the lack of policies and procedures affecting the control environment.

We reviewed the Department's fiscal year 2001 Government Performance and Results Act annual performance report and determined that none of the goals and measures were related to our objective.

In addition, we reviewed relevant financial reports on the WCF billings and budgetary reports for FYs 2000 and 2001 and contacted selected Departments that had WCFs to determine what, if any, reserves they maintained.

We performed site visits in Washington, D.C., Reston, VA, and Denver, CO.

## Prior Audit Coverage

We found that the OIG had not performed an audit on the Department of the Interior's Working Capital Fund in the last 5 years. We did find that the General Accounting Office had issued a report dated April 2002 on the Office of Aircraft Services. The report stated that the OAS has not fully recovered the costs associated with the aviation program. From fiscal years 1997 through 2000, OAS had charged bureaus about $4 million less than actual costs. GAO has not issued a report on the Department of the Interior Working Capital Fund in the last 5 years.

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# Response to Draft Report

United States Department of the Interior

OFFICE OF THE ASSISTANT SECRETARY
POLICY, MANAGEMENT AND BUDGET
Washington, D.C. 20240

MAY 3 0 2003

Memorandum

To: Inspector General

From: P. Lynn Scarlett

Subject: Draft Evaluation Report on the Department of the Interior Working Capital Fund (Assignment No. E-IN-OSS-091-02)

Thank you for providing us the opportunity to comment on the draft evaluation of the Department's Working Capital Fund (WCF).

The Working Capital Fund is a critical tool for operating the Department in a cohesive manner and for achieving efficient and cost effective administrative operations. With diverse national programs conducted by eight separate bureaus and several major offices and with funding provided through over 220 appropriated and permanent accounts, it is critical and essential for the Department to offer a central core of administrative operations common to all. The WCF enables the Department to invest wisely, streamline operations, and avoid the redundancy that otherwise would occur if each of our 2400 field entities pursued their own unique systems and administrative processes.

The Fund supports:

- A Department-wide accounting system (which serves all but two small organizational entities), a mainframe operation which is centrally housed and maintained for the benefit of all,

- IDEAS, the only successful Department-wide procurement system in the Government, providing a common approach to acquiring supplies, equipment, and other essential goods and services,

- FPPS, the Department-wide payroll and personnel system which was recently chosen because of its cost effectiveness by OMB and OPM to be one of four systems providing Government-wide payroll services, and

- Interior-wide procurement of aircraft and aircraft services through the Office of Aircraft Services, achieving safer and more efficient aircraft services for bureau programs.

The common services approach of the Working Capital Fund has achieved major cost savings for the Department and its bureaus. In the case of FPPS payroll services, for example, the per unit cost for payroll services was reduced by 26% from comparable 1989 levels. In 2002, this amounted to $5.3 million in cost avoidance for the Department's bureaus and offices. With the establishment of the National Business Center (NBC) in 1999, Interior consolidated two mainframe computer centers that supported administrative applications, resulting in rate reductions of $1.4 million for financial systems computer support annually. Additionally, the consolidation also produced annual savings for BIA and USGS totaling $1.2 million.

Your evaluation makes nine recommendations for improving management of the WCF. We support all nine of the recommendations, while suggesting a change in wording to only one.

I would strongly suggest that the recommendation dealing with funding authorized reserves not suggest that this be done through using what the report terms an "existing surplus." The phrase implies that the WCF contains funds in excess of our needs. The suggestion that there exists a "$20 million surplus" is unfortunate and misleading for several reasons. First, the report correctly indicates that reserves for annual leave and equipment replacement are appropriate and are authorized for the WCF. But the report fails to mention that the audited FY 2002 financial statement indicates that nearly $17 million has been identified for equipment depreciation and replacement. Consequently, while the exact number and cost of the items to be replaced must be scrutinized, the dollar size of the "surplus" is likely to be an amount considerably less than the $20 million described in the report. Secondly, the $20 million "surplus" reported in the study only includes four sub-accounts which have positive values and did not considered the overall impact that a possible reduction in resources might have on the entire fund. Consequently, the rescission of $20 million could have serious consequences for the solvency of the Fund as a whole. Finally, the report, of necessity, is based on funding levels reported at a given point in time. Most of the data in the report is based on FY 2001 end of year data, yet we are today operating in the eighth month of FY 2003, some 20 months later.

Consequently, I have asked Deputy Assistant Secretary - Budget and Finance to provide you and the Congress with the most recent Treasury data and current projected income and expense information so that the report is as current as we can make it and to determine the size of any amounts that may truly be available to fund authorized reserves or meet other requirements as defined by the Congress. This work is now nearing completion.

A number of efforts to improve WCF operations were already underway at the time of your review; your recommendations will speed these improvement efforts.
The consolidation of the Geological Survey, Bureau of Reclamation, and Office of the Secretary service centers into the NBC has provided more focus and better service to customers. Since that time NBC has been implementing changes to improve consistency in business practices, pricing policies and administrative cost rates. The evaluation report has been helpful in suggesting additional steps that should be taken to fully implement

the benefits of this consolidation. We have taken a number of steps since Fiscal Year 2001 to institute more business-like practices:

- The NBC conducted a successful pilot of activity base cost management, preparing it to provide more detailed cost information beginning October 1, 2003.

- Long standing reimbursable funding agreements have been incorporated into the WCF, providing increased information and clarity about services provided to bureaus.

- The DAS – Budget and Finance held joint consultation meetings on WCF costs and billing processes for FY 2003 and FY 2004 last August and September with all bureaus.

- The NBC established administrative cost rates for each of its business lines for Fiscal Year 2003 which will be reviewed annually.

A critical factor in our improvement efforts is continuing communication with our bureau "customers." While meetings with each bureau on its cost of services have always occurred and budgetary adjustments made in our budget requests to Congress, we have again begun to involve bureaus more actively to shape our WCF decisions.

To this end, the Deputy Assistant Secretary – Budget and Finance will continue the dialogue with bureaus on WCF services and pricing policies. This effort has now been formalized with establishment of a Working Capital Fund Consortium. The Consortium, which includes bureau and Department representatives met earlier this month. Future meetings of the Consortium will assist in development of the 2005 WCF budget in the review of final 2004 WCF costs and in the implementation of the WCF improvement plan resulting from your review.

Since the WCF is a significant tool in our overall management of the Department, it is important that the report communicate as clearly and as accurately as possible on its overall status and condition. To that end, I have attached a more detailed set of responses to your report that should assist in the formulation of your final version of the evaluation. These responses should help clarify areas of the report, while not in any significant way altering either your final recommendations or the work we have underway.

We have also attached a copy of the draft WCF improvement plan which describes the tasks, time table and accountable officials who will implement the improvements. This improvement plan is under discussion with the WCF Consortium.

Attachments

cc: Regional Audit Manager, Eastern Region

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

Executive Summary:

*Page i, Paragraph 2:* "The WCF finances the operations of the National Business Center (NBC), which provides products and services; the Office of Aircraft Services (OAS), which operates all aircraft activities; and other DOI management activities such as the Office of the Chief Information Officer."

*Suggest:* Common support services are provided by: the National Business Center (NBC), which provides products and services; the Office of Aircraft Services (OAS), which operates all aircraft activities; and DOI Departmental Offices.

*Rationale:* The first paragraph accurately explained the purpose of the Working Capital Fund. The terminology used in this paragraph implies to the reader that the sole reason for the WCF is to fund the NBC, OAS and all DOI management activities. During this time period, the NBC was also funded by the Interior Franchise Fund (IFF), which is not mentioned in this report. In addition, the fund is used to support common operational activities performed by the Department through the WCF.

*Page i, Paragraph 3:* "In an attempt to standardize procedures and simplify operations, the WCF merged three of its services centers into the NBC in 1999."

*Suggest:* In an attempt to standardize procedures and simplify operations, the Department merged three of its service centers into the NBC in 1999.

*Rationale:* The Department (not the WCF) made the decision to merge the service centers.

*Page i, Paragraph 3:* "During our evaluation, however, we found that the NBC continues to operate as three separate components with the original redundancies."

*Suggest:* During our evaluation, however, we found that the NBC continues to operate with some of its original redundancies.

*Rationale:* The NBC has consolidated the budget, procurement operations and systems, finance operations and systems, human resources, mail policy, emergency preparedness, property management, environmental compliance, capital planning investment, and payroll organizational functions from the three centers.

*Page I, Paragraph 4:* "Other concerns disclosed by our evaluation – many resulting from the lack of integration at the NBC – are summarized below:"

*Suggest:* Other concerns disclosed by our evaluation are summarized below:

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

*Rationale:* Since several organizations used the WCF, these recommendations are not specifically attributable to a lack of integration at the NBC.

*Page i, 1st Bullet:* "The WCF accumulated a $20 million surplus as of September 30, 2001. WCF officials were unaware of this surplus prior to our evaluation."

*Suggest:* A portion of the WCF had accumulated cumulative results of operations of $20 million as of September 30, 2001. Some WCF officials could not explain these cumulative results of operations.

*Rationale:* This amount represents cumulative results of operations, not a "surplus." A surplus indicates to the reader that there is excess cash. Based on our meetings with IG audit staff, the $20 million represents the cumulative results of operations of four of the funds within the WCF (WB, WC, WD and WF). Cumulative results are not synonymous with "surplus." "Surplus" means funds in excess of operational needs or excess reserves. In fact the IG recommends the use of these funds for reserves.

*Page i, 2nd Bullet:* "The WCF plans to increase prices to fund six reserves, four of which we believe are not authorized. In addition, the planned price increases did not consider the $20 million surplus."

*Suggest:* The NBC considered increasing prices to fund six reserves, four of which we believe are not authorized. The increase did not consider the $20 million cumulative results of operations.

*Rationale:* Although it had been approved by NBC management, it was never presented to nor was it approved by appropriate officials within the Office of the Secretary.

*Page ii, 4th Bullet:* "The WCF charged bureaus and offices for activities also funded by direct appropriations."

*Suggest:* The WCF was used to fund activities provided by offices which also receive direct appropriations.

*Rationale:* The Departmental funds operational activities performed by Departmental Offices through the WCF. These same offices receive appropriated funds for policy and oversight activities.

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

Introduction:
Background:

*Page 1, Footnote 2:* "OAS merged into the WCF in FY 2002."

*Suggest:* OAS merged with the NBC in FY 2002.

*Rationale:* OAS has been funded through the WCF since inception in 1973.

*Page 1, Paragraph 2:* "The WCF finances the operation of the National Business Center (NBC), the Office of Aircraft Services (OAS), and departmental management activities."

*Suggest:* Common support services are provided by: the National Business Center (NBC), which provides products and services; the Office of Aircraft Services (OAS), which operates all aircraft activities; and DOI Departmental Offices that provide operational activities supporting bureaus such as making assignments for radio spectrum use in the field.

*Rationale:* This clarifies NBC and OAS responsibilities and explains that common operational activities performed by the Department are funded through the WCF.

Results of Evaluation:

*Page 3, 1st Bullet:* "WCF officials were unaware of an accumulated $20 million surplus as of September 30, 2001."

*Suggest:* Some WCF officials were unaware of a $20 million cumulative results of operations in part of the WCF as of September 30, 2001.

*Rationale:* This amount represents cumulative results of operations, not a "surplus," as mentioned earlier.

*Page 3, 2nd Bullet:* "The WCF did not establish authorized reserves for accumulated annual leave and equipment replacement."

*Suggest:* WCF managers did not establish authorized reserves for equipment replacement.

*Rationale:* Accumulated annual leave is an item that appears on the balance sheet for the WCF. It is already considered in the calculation of cumulative results of operations. Establishing an amount for accumulated annual leave other than the amount that appears on the balance sheet for the WCF would not be appropriate.

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

*Page 3, 2nd Bullet:* "Furthermore, the WCF plans to implement four other reserves, which we believe are not authorized, and then plans to raise prices to fund all six reserves."

*Suggest this sentence be deleted*

*Rationale:* Although it had been approved by NBC management, it was never presented to nor was it approved by appropriate officials within the Office of the Secretary.

*Page 3, 3rd Bullet:* "The WCF charged bureaus and offices for activities also funded by direct appropriations."

*Suggest:* The WCF was used to fund activities provided by offices which also receive direct appropriations.

*Rationale:* The Departmental funds operational activities performed by Departmental Offices through the WCF. These activities, performed by Departmental offices, avoid the need for each Bureau to independently provide these services, thereby reducing the cost.

<u>Surplus of $20 Million:</u>

*Page 3, Section Header:* "Surplus of $20 Million"

*Suggest:* Cumulative Results of Operations of $20 Million

*Rationale:* This amount represents cumulative results of operations, not a "surplus," as mentioned earlier.

*Pages 3 & 4, Paragraph 3:* "The WCF had accumulated a $20 million surplus as of September 30, 2001. WCF officials were unaware of this surplus prior to our evaluation. Our analysis shows that approximately $17 million of the surplus was accumulated prior to the organizational merger in 1999, and an additional $3 million was accumulated in FYs 2000 and 2001. Since the WCF tracks revenue and expense by billing type, we found that DOI bureaus accounted for approximately $14 million, or 70 percent, of the $20 million surplus. DOI officials were unable to provide an explanation or analysis of the surplus. In the absence of any other credible explanation afforded by the Department, we believe that charging customers for more than the cost of delivering services was the principal cause of the surplus. We found instances where customers were charged less than the cost of delivering services. We attribute this overcharging and under charging to an accounting system that cannot track revenues by products and services and the lack of a standard billing process."

*Suggest:* A portion of the WCF had cumulative results of operations of $20 million as of September 30, 2001. An analysis done by a WCF official showed that approximately $17 million

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

of this came as a result of the organizational merger in FY 1999, and an additional $3 million was accumulated in FY 2000 and FY 2001. Approximately $14 million or 70% of this amount should be reserves for accumulated depreciation. WCF officials failed to establish appropriate procedures to manage these reserves.

*Rationale:* Based on an accounting system conversion that took place in FY 2001, data does not exist to substantiate the conjecture in this paragraph. In addition, the report points out that a reserve needs to be established for accumulated depreciation, without considering that reserve, it cannot be determined if customers have been overcharged.

<u>Accurate cost information on business lines lacking:</u>

*Page 4, Paragraph 2:* "Although the FFS can track revenue and expenses by billing type, it is unable to do the same by products and services."

Suggest: Although the FFS contains data to track revenue and expenses by billing type, it does not contain detailed enough data to do the same by products and services.

Rationale: This is a data problem, not a problem specific to FFS.

<u>Standardized Billing Process Needed:</u>

*Page 4, Paragraph 3:* "The WCF does not have a standardized billing process. Although the WCF merged it service centers in 1999, it continues to function as three separate organizations using three separate billing methods."

*Suggest:* The WCF needs to better document and communicate billing practices by service and service provider:

*Rationale:* The WCF has standardized the billing process for like services. Three methods of billing are available to address customer needs and the nature of the service provided. For example, centralized billing is used when services are not fully severable and the cost of determining actual use is inefficient and not particularly cost effective. This would include services such as the loading dock in the Main Interior Building. Fixed fee billing is used when the services are severable, optional, and the output is specifically identified. An example of fixed fee would be the Minority Intern program whereby bureaus use an enterprise wide contract to obtain minority interns on a short-term basis. The direct billing method is used for time and materials agreements when the service is severable yet the exact amount of resource requirement for the service is unknown. An example would be the NBC building a web site for a customer. It lacks documentation to explain how this is accomplished, however tacit knowledge of this process exists. Each of these billing methodologies is an accepted business practice and has been discussed and agreed to by the customers.

Attachment A

Page 5

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

*Pages 4 & 5, Paragraph 4:* "Although revenue from direct billing (customers outside the department) was similar to revenue from centralized billing (DOI customers), DOI customers paid the majority of the surplus, as shown in figure 2."

*Suggest delete this sentence.*

*Rationale:* Although the revenue and expense for the fund as a whole are correct, the revenue and expense by fund should be considered non-severable, especially four the four funds in this analysis. Therefore cumulative results of operations should not be considered separately.

*Page 5, Figure 2*

*Suggest delete this figure.*

*Rationale:* As mentioned above, separating the data in these four funds shows a distorted view. Depreciation charged in one fund may have been allocated to two or more of the funds in question.

*Page 5, Paragraph 2:*"We determined that the billing method used to charge DOI customers is based on estimates that are adjusted infrequently, whereas bills sent to customers outside the department are more closely related to actual costs."

*Suggest:* We determined that the billing method used to charge in the consolidated billing fund is based on estimates provided up to two years in advance for inclusion in the budget process, whereas other billing methods can provide estimates more closely related to current costs.

*Comment:* In order to include the appropriate adjustments for changes costs of WCF services for Interior customers they are formulated up to two years in advance. DOI customers participate in a mandatory shared service through the centralized billing process. Non-DOI customers are not locked into such an arrangement. Their costs reflect data for the period in which service was requested.

*Page 5, 1st Bullet:* "The WCF charged mail and messenger services to the Advisory Council for Historic Preservation in the Main Interior Building in FY 2002. Although the Council has occupied space in the Main Interior Building at one time, it had moved its offices to another location during FY 2001."

*Suggest this bullet be deleted.*

*Comment:* Even though the ACHP moved out of the building, it is still charged its proportional share of the cost for services for compiling and producing the Telephone Directory and the

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

automated Employee Locator Services. In addition, because ACHP is located a considerable distance from the MIB, employee time and vehicle use are required on a regular basis to deliver mail to the ACHP from other organizations located within the Interior Complex and/or serviced by the MIB Mailroom.

*Page 6, 1st Bullet:* "The WCF charged DOI bureaus and offices differently than external clients for its drug-testing program. The WCF charged its external clients an administrative fee that it did not charge the DOI bureaus, even though all customers received the same services."

*Suggest this bullet be deleted.*

*Comment:* The services are not the same and different charges are warranted. Internally, the Department uses all three components of the drug testing service (collection, lab analysis, and the Medical Review Officer). There are some agencies which only need to use specific components. For instance, the Drug Enforcement Agency has its own Medical Review Officer and only contracts with the NBC for collection and analysis.

Reserves:

*Page 6, Paragraph 1:* "The WCF had not established authorized reserves for accrued annual leave and equipment replacement. Instead the WCF financed these costs through current operations."

*Suggest:* WCF managers had not established an auditable process for reserves for equipment replacement.

*Rationale:* Accrued annual leave is a liability of the WCF, and thus already taken into account when arriving at cumulative results of operations. To reserve any additional cash for this would constitute double counting. It is an auditable process for legally allowed capital replacement reserves that is the missing piece.

*Page 6, Paragraph 1:* "During the evaluation, WCF officials informed us that they planned to establish six reserves – the two specifically authorized by legislation and four others for research and development, capital investment, contingencies, and shut down."

*Suggest:* During the evaluation, WCF officials informed us that they were considering establishing six reserves – the two specifically authorized by legislation and four others for research and development, capital investment, contingencies, and shut down.

*Rationale:* Although it had been approved by NBC management, it was never presented to nor was it approved by appropriate officials within the Office of the Secretary.

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

*Page 7, Paragraph 2:* "We believe that the WCF should (1) establish reserves only for accrued annual leave and equipment replacement, as authorized, (2) determine the amounts necessary to fund each reserve, and (3) fund the authorized reserves with part of its $20 million surplus instead of through price increases."

*Suggest:* We believe that the WCF should (1) establish reserves for equipment replacement, as authorized, (2) determine the amount necessary to fund the reserve, and (3) fund the authorized reserves with the $20 million in cumulative results before considering price increases.

*Rationale:* Accrued annual leave has already been included in the calculation of cumulative results to fund them again would constitute double counting. A process is needed to establish the amount for equipment reserves. The cumulative results of operations should not be termed a "surplus."

Method of funding Departmental Management needs clarification

Page 8, Paragraph 2: "DOI management officials believe that this method of funding is appropriate and is clearly disclosed in the budget justifications."

*Suggest:* DOI management officials believe that there is a distinction between the funding of policy and oversight activities and operational activities that serve all bureaus. These factors are clearly disclosed in the budget justifications for Departmental Management and the WCF. They agree to continually improve the clarity of these presentations.

Rationale: There is a distinction between oversight and activities that are operational in nature. We will continue to clarify this with the Congress.

Information to DOI Customers

*Page 9, Paragraph 6:* "For example, in FY 2003, the WCF billed three DOI bureaus an additional $2.2 million over original estimates: the Office of the Secretary, $180, 000; the National Park Service, $690,000; and the Bureau of Land Management, $614,000."

*Suggest:* For example, in FY 2003, the WCF billed three DOI bureaus an additional $2.2 million over original estimates: the Office of the Secretary, $878, 000; the National Park Service, $690,000; and the Bureau of Land Management, $614,000.

Rationale: These adjustments were appropriate based on additional services received. The amounts shown in the draft report tally up to $1.484 million, there is a typographical error on the figure for Office of the Secretary.

Attachment A

Page 8

**Comments and Clarifications**
**OIG Draft Evaluation Report on the Department of the Interior Working Capital Fund**

Recommendations

*Page 11, Number 5:* "Fund authorized reserves with existing surplus."

*Suggest:* Fund authorized reserves with cumulative results of operations.

*Rationale:* These funds are not "surplus," but are the cumulative results of operations. As recommended by the IG, these funds are needed for reserves.

Appendix 1

*Page 12:* List of Products and Services

*Comment:* An updated list of products and services is attached. (Attachment C)

# Status of Recommendations

| Recommendations | Status | Action Required |
|---|---|---|
| 1,2,3,4,5,7,8 and 9 | Resolved, Not implemented | No further response to the Office of Inspector General is necessary. The recommendations will be referred to the Department's Audit Followup Official for tracking of implementation. |
| 6 | Management concurs; additional information needed | Provide an action plan, including a target date and the title of the official responsible for seeking clarification from the House and Senate Subcommittees on Appropriations. |

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