United States General Accounting Office

GAO

Report to the Committee on Government Reform, House of Representatives

August 2003

BUDGET ISSUES

Franchise Fund Pilot Review

Accountability ★ Integrity ★ Reliability

GAO

Accountability • Integrity • Reliability

Highlights

Highlights of GAO-03-1069, a report to the Committee on Government Reform, House of Representatives

August 2003

BUDGET ISSUES

Franchise Fund Pilot Review

Why GAO Did This Study

Congress is considering the reauthorization of the six franchise fund pilots authorized by the Government Reform Act of 1994. These self-supporting business-like entities were established to provide common administrative services on a fully reimbursable basis. The authorization for most of the pilots will expire at the end of fiscal year 2003. In addition to the suggestion of giving the pilots permanent authorization, there has been some discussion in recent years of expanding the franchise fund concept so that all departments and independent agencies can set up a franchise fund. To provide the context to evaluate franchise fund pilots and fully understand reauthorization issues, GAO agreed to identify the many funds, called intragovernmental revolving funds, that operate with purposes similar to that of franchise funds and to analyze their legal authorities to determine if franchise funds were somehow unique. In addition, we examined the operations and managerial cost accounting processes of the franchise fund pilots at the Departments of the Interior and Commerce. We determined if they had taken into account the criteria suggested by the Office of Management and Budget (OMB), including: (1) adhering to OMB/Chief Financial Officers (CFO) Council's 12 business operating principles, (2) accounting for full cost, and (3) conducting audits of financial statements at the fund level.

www.gao.gov/cgi-bin/getrpt?GAO-03-1069.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Susan J. Irving at (202) 512-9142 or irvings@gao.gov.

What GAO Found

The six franchise fund pilots are part of a group of 34 intragovernmental revolving (IR) funds that were created to provide the common support services required by many federal agencies. In general, the legal authorities for these 34 funds are very similar. Twelve of the 34 funds—including 5 of the franchise fund pilots—have explicit authority to charge for an operating reserve and/or to retain a reserve for acquisition of capital equipment and financial management improvements.

The franchise fund pilots at the Departments of Interior and Commerce have both (1) taken into account many of the 12 business operating principles, (2) designed their cost accounting processes to set fees to recover the full cost of operations, and (3) progressed toward implementing the main cost accounting standards. The Interior Franchise Fund's (IFF) major business line, GovWorks, provides acquisition services and has seen dramatic growth in revenue and workload since fiscal year 1997. GovWorks expects continuing growth through fiscal year 2007. The IFF has been subject to an audit of its financial statements at the franchise fund level through fiscal year 2002. The Commerce Franchise Fund's (CFF) only business line, Office of Computer Services (OCS), provides information technology infrastructure support services and has had a declining revenue and customer base. However, OCS expects its revenues to remain stable through fiscal year 2005. The CFF was subject to financial audits at the franchise fund level for fiscal years 1997 and 1998, and at the department level for fiscal years 2001 and 2002. No audits were conducted for fiscal years 1999 or 2000.

Longer-term reauthorization (more than 1 or 2 years) would be helpful to the operation of franchise fund pilots, but neither their legal authority nor their operation makes franchise funds unique compared to other IR funds. A primary attraction to the franchise fund label is the explicit ability to retain reserves, and Congress could, and has, given this authority to other IR funds. The explicit authority provisions granted to franchise fund pilots (and a few other IR funds) could be considered case-by-case for individual IR funds. In deciding whether to provide these authorities to any individual fund, Congress could use the same criteria suggested by OMB for franchise fund pilots, including: (1) examining operations against OMB/CFO's 12 business operating principles, (2) determining if managerial cost accounting processes are in place to account for the full unit costs of outputs produced, and (3) considering if annual or periodic independent audits are being conducted at the fund level to ensure the reliability of the fund's financial information. Individual case-by-case authority would also permit Congress to consider and evaluate the agency's commitment and the strength of the IR fund's leadership, which are additional factors that can influence the success of the fund.

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United States General Accounting Office
Washington, D.C. 20548

August 22, 2003

The Honorable Tom Davis
Chairman
The Honorable Henry A. Waxman
Ranking Minority Member
Committee on Government Reform
House of Representatives

In your January 9, 2003, letter you asked us to evaluate the franchise fund pilots authorized by the Government Management Reform Act of 1994 as you consider their reauthorization. To fully understand reauthorization issues, we agreed to (1) examine the universe of intragovernmental revolving (IR) funds[1] (of which franchise funds are a type) and their legal authorities and to determine how these authorities differ, (2) study the operations of selected franchise fund pilots, and (3) identify issues that Congress might consider as it contemplates permanent reauthorization of franchise funds. On July 11, 2003, we briefed committee staff on the results of our work. As agreed with your office, this letter summarizes and transmits the information provided in that briefing.

We used budget data to identify IR funds and reviewed the *U.S. Code* to analyze their legal authorities. We selected the franchise fund pilots at the Departments of the Interior and Commerce for case studies. We determined that GovWorks is the primary component of the Interior franchise fund (IFF) and that the Office of Computer Services (OCS) is the sole component of the Commerce franchise fund (CFF), and our case-study work focused on these two entities. We interviewed agency officials at the department and franchise fund levels, examined a variety of documentation, and did an in-depth review of the managerial cost accounting processes at the franchise fund level. During this review, we examined work done by other auditors and performed limited testing of data reliability but did not conduct audit procedures designed to render an opinion on the franchise funds' financial information. We obtained comments from GovWorks and OCS on a draft of the report relevant to each and incorporated those comments, which were technical in nature,

[1] An IR fund conducts continuing cycles of business-like activity within and between government agencies. It charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations.

where appropriate. Our work was conducted in Washington, D.C., from January through July 2003, in accordance with generally accepted government auditing standards. (See pages 12 to 14.)

Results in Brief

Although longer-term authorization for franchise fund pilots would be helpful to the operation of the funds and their clients, neither their legal authority nor their operation makes franchise funds unique compared to other IR funds. A primary attraction to the franchise fund label is the explicit ability to retain 4 percent of total annual income, and Congress could, and has, given this authority to other IR funds. Since most large agencies already have at least one IR fund, allowing all departments and independent agencies to set up franchise funds is unnecessary. Instead, the explicit authority provisions granted to franchise fund pilots (and a few other IR funds) could be considered case-by-case for individual IR funds. In deciding whether to provide these authorities, Congress could use the same criteria suggested for franchise fund pilots, including: (1) examining operations against the 12 business operating principles established by the Office of Management and Budget (OMB) and the Chief Financial Officers (CFO) Council, (2) determining if managerial cost accounting processes are in place to account for the full unit costs of outputs produced, and (3) considering if annual or periodic independent audits are being conducted at the fund level to ensure the reliability of the fund's financial information. Individual case-by-case authority would also permit Congress to consider and evaluate the agency's commitment and the strength of the IR fund's leadership, which are additional factors that can influence the success of the fund. (See pages 47 and 48.)

Background

Federal agencies are prohibited by law from transferring funds from one agency to another, unless otherwise authorized by law. The Economy Act of 1932 authorizes a federal agency to provide goods or services to another federal agency and generally provides authority for federal agencies to enter into intragovernmental transactions when no other, more specific, authority applies. However, the Economy Act restricts flexibility by requiring the client agency to deobligate fiscal year funds at the end of the period of availability to the extent that these funds have not been obligated by the performing agency. In contrast, where an interagency agreement is based on specific statutory authority other than the Economy Act, an agency is not required to deobligate funds at the end of the period of availability. The specific legal authorities creating IR funds authorize these funds to enter into intragovernmental transactions and provide more flexibility by allowing the client agency's fiscal year funds to remain obligated, even after the end of the fiscal year, to pay the IR fund for the provision of services which meet a legitimate or bona fide need incurred during the period of availability of the customer agency's appropriation.[2,3]

The Government Management Reform Act of 1994 authorized OMB to designate six franchise fund pilots. These pilots are a type of IR fund that were established as self-supporting business-like entities providing common administrative services on a fully reimbursable basis. Between May 1996 and January 1997, OMB designated pilots at the Departments of Commerce, Veterans Affairs (VA), Health and Human Services (HHS), the Interior, and the Treasury, and at the Environmental Protection Agency (EPA). As criteria for operation, OMB and the CFO Council defined 12 business operating principles for the franchise fund pilots.[4] OMB also stressed the importance of accounting for full cost[5] and suggested that agencies consider the usefulness of audited financial statements at the fund level. The six pilots provide a variety of common services, such as acquisition management, financial management services, and employee assistance programs. They are similar to other business-like entities such as the National Finance Center (NFC) at the Department of Agriculture and the Federal Systems Integration and Management Center (FEDSIM) at the General Services Administration (GSA).

The pilots were originally to expire at the end of fiscal year 1999, but the date has been extended three times (the last two times on an annual basis). As of August 2003, authorization for most of the pilots will expire at the end of fiscal year 2003. The Treasury franchise fund is authorized through the end of fiscal year 2004 and the EPA pilot has permanent authorization. In

[2] The use of a revolving fund does not change the period of availability of the customer agency's appropriation. It is improper for a customer funded by fiscal year appropriations to place orders in excess of legitimate needs, thereby using the revolving fund to extend the life of the appropriation.

[3] This is only one of the differences between the Economy Act of 1932 and the legal authorities for IR funds, but it is the one most important for our discussion. Other differences are mentioned on page 15.

[4] See appendix II for a list of the 12 business operating principles.

[5] The Statement of Federal Financial Accounting Standards (SFFAS) No. 4 sets forth basic cost accounting concepts and five main standards for managerial cost accounting by the federal government.

addition to suggestions of permanent authorization for the pilots, there has been some discussion in recent years of expanding the franchise fund concept governmentwide, that is, allowing all departments and independent agencies to set up franchise funds.

Intragovernmental Revolving Funds and Their Legal Authorities

We identified 58 IR funds with varying titles and purposes. Most IR funds function under the title or label “working capital fund.” Examples of other labels include revolving funds, supply funds, and franchise funds. Most large agencies have at least one IR fund, and many have more than one. For example, Interior has a franchise fund pilot and four working capital funds. Intragovernmental revolving funds were created for a variety of purposes, but most frequently, to provide the common support services required by many federal agencies. Examples include photocopying, payroll services, information technology services, and financial management services. We determined that 34 of the 58 IR funds provide common services, while the remaining 24 have very specific purposes of providing goods or services to satisfy needs unique to their agencies. (See pages 22 and 23.)

The 34 IR funds that provide common services operate under similar legal authorities. These authorities generally specify the means of initial capitalization and allow both internal entities and external agencies to pay the IR funds for services provided, either by reimbursement or in advance (some are required to receive payments in advance). Intragovernmental revolving funds are generally required to charge rates for their services sufficient to recover all operational expenses, although over the long term they are not intended to earn more than is required to break-even. In fact, the legal authorities for IR funds commonly require the return of surplus amounts to the Treasury at the end of the fiscal year. However, some receipts may be carried over to the next fiscal year as unobligated balances, including amounts reserved to cover the costs of annual leave and depreciation. Some additional discretion to carry over unobligated balances is provided to 22 of the 34 IR funds. For example, the head of the agency is allowed to determine the level of funding required to meet the needs of 16 of the IR funds and 6 IR funds are not specifically required to return surpluses to the Treasury. This discretion does not mean that IR funds are allowed to operate with continuing surpluses; over the long term, they are still required to break-even. The remaining 12 of the 34 funds—including 5 of the franchise fund pilots—have explicit authority to retain additional unobligated balances. By statute, the 12 funds are authorized to charge for an operating reserve and/or to retain a reserve for acquisition of capital equipment and financial management improvements. Five of the franchise fund pilots have explicit authority for both a “reasonable operating reserve” and “to retain up to 4 percent of total annual income for acquisition of capital equipment and financial management improvements.”[6] Appendix 3 shows the various authorities by fund. (See pages 24 through 27.)

Operations of the Franchise Fund Pilots at Interior and Commerce

During our case studies at the Interior and Commerce franchise fund pilots, we found that both have (1) taken into account many of the 12 business operating principles, (2) designed their cost accounting processes to set fees to recover the full cost of operations, and (3) progressed toward implementing the five main cost accounting standards.[7] The IFF’s major business line, GovWorks, provides acquisition services and has seen dramatic growth in revenue and workload since fiscal year 1997. GovWorks projects continuing growth through fiscal year 2007. The IFF has been subject to an audit of its financial statements at the franchise fund level through fiscal year 2002. The CFF’s only business line, OCS, provides information technology infrastructure support services and has had a declining revenue and customer base. However, OCS expects its revenues to remain stable through fiscal year 2005. The CFF was subject to financial audits at the franchise fund level for fiscal years 1997 and 1998, and at the department level for fiscal years 2001 and 2002. No audits were conducted for fiscal years 1999 or 2000. (See pages 28 through 35 for the IFF and pages 36 through 43 for the CFF.)

Reauthorization Issues

During the course of our work, we identified several reauthorization issues. Franchise fund managers cited the benefits of working under the franchise fund label and perceived the ability to retain 4 percent of total annual income as a benefit of a franchise fund. However, there is not a clear understanding of the relationship between the “4 percent retention” provision and the “operating reserve” provision. Clarification of the

[6] The HHS franchise fund pilot operates under the statutory authority for the HHS service and supply fund, which is not required to return excess to the Treasury. There is no explicit authority specifying an operating reserve or the retention of up to 4 percent of annual income, although HHS franchise fund officials believe that they are allowed this authority according to Chief Financial Officers Council, *Federal Franchise Pilots: Pilot Program Implementation Guide* (Washington, D.C.: April 1996).

[7] The standards are set forth in SFFAS No. 4.

relationship between these two provisions could avoid different interpretations. (See pages 44 and 45.)

If franchise funds were to be reauthorized, longer term reauthorizations (i.e., more than 1 or 2 years) would be beneficial and might provide less uncertainty for current and potential clients than do annual reauthorizations. Franchise fund managers mentioned other changes that might be helpful. Although the ability to receive payment in advance is sometimes advantageous, the requirement for advance payment reduces the IR funds' flexibility to work with some clients. One franchise fund manager said that additional human capital flexibilities, such as in hiring practices, might be beneficial. (See page 45.)

If the pilots were not reauthorized, many of the services provided would probably continue under other authorities. For example, both GovWorks and OCS operated under different authorities prior to becoming part of their respective franchise fund pilots. OCS officials told us that they would probably continue to operate under the authority of the working capital fund if the CFF pilot did not continue. GovWorks would seek authorization as a working capital fund so that it would not have to operate under the authority of the Economy Act. (See page 46.)

As agreed with your office, unless you announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. At that time, we will provide copies of this report to other interested congressional committees and make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions regarding the information in this report, please contact me at (202) 512-9142 or Christine Bonham, Assistant

Director, at (202) 512-9576. Key contributors to this review were Jennifer A. Ashford, Michael S. LaForge, Bill Wright, Hannah R. Laufe, Mark P. Connelly, and Elizabeth Lessman.

Susan J. Irving
Director, Federal Budget Analysis
Strategic Issues

Franchise Fund Pilot Review

Franchise Fund Pilot Review

Briefing for Chairman Davis and Ranking Member Waxman

Committee on Government Reform

U.S. House of Representatives

July 11, 2003

Introduction

- The Government Management Reform Act (GMRA) of 1994 authorized the Office of Management and Budget (OMB) to designate six franchise fund pilots:
  - One of many types of intragovernmental revolving (IR) funds
  - Self-supporting business-like entities providing common administrative services on a fully reimbursable basis
  - Compete for federal customers, both internal and external
  - OMB designated the following six pilot agencies:
    - Interior (May 17, 1996)
    - Treasury (May 17, 1996)
    - Commerce (May 20,1996)
    - Environmental Protection Agency (EPA) (May 30, 1996)
    - Veterans Affairs (VA) (May 30, 1996)
    - Health and Human Services (HHS) (January 24, 1997)

Introduction

- Original expiration extended three times
- Current expiration at end of fiscal year 2003; Treasury franchise fund will expire at end of fiscal year 2004
- Little literature is available regarding franchise fund pilots' operations
- Expanding the franchise fund concept on a governmentwide basis has been discussed in recent years
- In consideration of reauthorization, need to understand the universe of similar types of IR funds and the operation of the pilots

Key Questions

1. What types of intragovernmental revolving funds exist, under what authorities do they operate, and how do these authorities differ?

2. How have selected franchise funds operated?

3. What issues might Congress consider as it contemplates permanent reauthorization of franchise funds?

Scope and Methodology

- To identify IR funds and their legal authorities, we:
  - Used budget data from OMB's MAX budget database
  - Reviewed *U.S. Code* and fund information in the President's 2004 Budget
- For background on franchise funds and their operations, we examined:
  - 1997 and 1999 OMB/Chief Financial Officers (CFO) Council reports on franchise funds
  - Legal and budget documents, GAO reports, agency documents
  - Documentation from franchise fund websites and magazine articles
- For detailed information on operations, we selected Interior and Commerce franchise funds for case studies based on size and activity:
  - Interviewed agency officials at the department and franchise fund levels
  - Examined original franchise fund applications, Inspector General reports, and other documentation on the history and operation of the funds
  - Examined each against specific OMB/CFO Council operating principles and determined whether franchise funds had taken into account these principles

Scope and Methodology (cont.)

- We also examined in-depth the managerial cost accounting processes at:
  - GovWorks, which makes up over 95 percent of all Interior franchise fund revenues as of October 1, 2002
  - Office of Computer Services (OCS), currently the only business line within the Commerce franchise fund
- By studying their cost accounting processes, we were able to:
  - Gain an understanding of their financial operations
  - Review underlying methodologies for identifying, accumulating, and assigning costs to cost objects
  - Trace sources for cost-related information in internal management reports to supporting systems and documentation
  - Investigate anomalies or potential problems found in the design of the costing processes and discuss these issues with agency officials

Scope and Methodology (cont.)

- Reviewed work by other auditors and performed limited testing of data reliability, but did not conduct audit procedures designed to give an opinion on the franchise funds’ financial information
- Reauthorization issues were identified during our document reviews and interviews
- GovWorks and OCS have each reviewed the relevant slides; they provided technical comments which have been incorporated where appropriate
- Conducted our work between January and July 2003 in accordance with generally accepted government auditing standards

Background–Intragovernmental Revolving Funds

- The Economy Act of 1932 provides broad authority:
  - Allows a federal agency to enter into an agreement to provide goods or services to another federal agency, and generally is the authority governing intragovernmental transactions when no other, more specific, authority applies
  - Requires that payment from the client agency be based on the "actual cost of goods or service" provided
  - Restricts flexibility by requiring client agency to <u>deobligate fiscal year funds at end of period of availability</u> to the extent unobligated by the performing entity
- In contrast, specific legal authorities creating IR funds at the agency level:[1]
  - Describe the fund's purpose and authorized uses
  - Detail the receipts or collections the agency may credit to the fund
  - Provides more flexibility by allowing client agency funds to remain obligated, even after the end of the fiscal year, to pay the performing IR fund
  - Other authorities specific to the fund

[1] There are other types of revolving funds that share common elements with IR funds, but they are not relevant to our discussion. IR funds are revolving funds whose receipts come primarily from other government accounts.

Background–Franchise Fund Pilots

- Franchise funds are a type of IR fund
- First conceptualized in the 1993 National Performance Review to establish fully self-supporting business-like entities within the federal government to compete in the market to provide federal common administrative support services
- GAO reported and testified on the franchise concept in early 1994[2] and questioned whether governmentwide legislation was necessary since the concept so closely resembled existing IR funds
- GMRA 1994 authorized OMB to designate six franchise fund pilots
- OMB chose pilots through an application process
- Legal authorities for pilots:
  - Five of the six pilots received authority in respective agency's appropriations bill (all but HHS)
  - HHS pilot operates under authority of the HHS service and supply fund
  - EPA franchise pilot established as a "working capital fund" and law was amended so fund has no expiration date

[2] See U.S. General Accounting Office reports *Improving Government*: *GAO's Views on H.R. 3400 Management Initiatives,* GAO/T-AIMD/GGD-94-97 (Washington, D.C.: Feb. 23, 1994) and *Working Capital Funds: Three Agency Perspectives,* GAO/AIMD-94-121 (Washington, D.C.: May 20, 1994).

Background–Franchise Fund Pilots (cont.)

- Pilots did not begin to operate until fiscal year 1997
- OMB and the CFO Council defined 12 operating principles for business-like operations in a 1996 guide for franchise fund pilots:[3]

1. Services	7. Adjustments to Business Dynamics
2. Organization	8. Surge Capacity
3. Competition	9. Cessation of Activity
4. Self-sustaining/Full Cost Recovery	10. Voluntary Exit
5. Performance Measures	11. FTE Accountability*
6. Benchmarks	12. Initial Capitalization*

* We did not examine these principles in our case study of the Interior and Commerce Franchise Funds

- In addition to emphasizing these 12 principles, OMB has stressed the importance of accounting for full cost and suggested that agencies consider the usefulness of audited financial statements at the fund level
- Statement of Federal Financial Accounting Standards (SFFAS) No. 4 sets forth basic cost accounting concepts and five main standards for managerial cost accounting by the federal government

[3] See appendix 2 for description of principles.

Background–Franchise Fund Pilots (cont.)

- Franchise fund pilots provide common administrative services such as:
  - Acquisition management
  - Information technology services
  - Records management
  - Facilities management
  - Administrative management
  - Financial management services
  - Employee assistance programs
  - Clinical occupational health
- Franchise fund pilots are often discussed in the literature with other recognized business-like entities such as:
  - Agriculture's National Finance Center (NFC)
  - Central Intelligence Agency's (CIA) central services working capital fund (WCF)
  - General Services Administration's (GSA) Federal Systems Integration and Management Center (FEDSIM)
  - Cooperative administrative support units (CASUs)

Results in Brief

- Identified 58 IR funds with varying labels and purposes:
  - Determined that 34 IR funds (including 6 franchise fund pilots) are authorized to provide common services required by many federal agencies; 24 IR funds have more specific purposes
  - In addition to the 58 IR funds, we identified cooperative administrative support units, another type of government entity that provides common services
- 34 intragovernmental revolving funds <u>that provide common services</u> operate under similar legal authorities:
  - For example, most authorize advances and reimbursements, as well as the carryover of unobligated balances to recover the costs of accrued leave and depreciation
  - Some, but not all, have authority <u>explicitly</u> allowing 1) an operating reserve and/or 2) retention of up to 4 percent of total annual income for capital equipment/financial management improvements

Results in Brief (cont.)

- Interior and Commerce franchise fund pilots have:
  - Taken into account many of the business operating principles
  - Designed their cost accounting processes to set fees to recover the full cost of operations
  - Made progress toward implementing the five main cost accounting standards set forth in SFFAS No. 4
  - Had financial statement audits performed at different levels
- Interior franchise fund's (IFF) major business line, GovWorks:
  - Provides acquisition services
  - Has seen dramatic growth in revenue and workload since fiscal year 1997 and projected through fiscal year 2007
- Commerce franchise fund's (CFF) business line, OCS:
  - Provides information technology (IT) infrastructure support services
  - Has had a declining revenue and customer base, but OCS expects revenues to remain stable through fiscal year 2005

Results in Brief (cont.)

- We identified several reauthorization issues:
  - Franchise fund managers cited benefits of working under the franchise fund label
  - Ability to retain 4 percent of total annual income is generally perceived as a benefit of a franchise fund
  - If reauthorized, longer-term authorization for selected franchise fund pilots would be beneficial
  - If not reauthorized, many services being provided under franchise funds probably would continue under other authorities
  - Franchise funds are not unique from other IR funds in their legal authority or operation
  - Expanding franchise funds governmentwide is not necessary since funds are individually authorized and may receive expanded authorities from Congress

58 intragovernmental revolving funds have varying labels and purposes

- IR funds exist under a variety of labels, with "working capital fund" being the most common:

– 28 working capital funds	– 3 supply funds
– 6 revolving funds	– 3 building funds
– 5 franchise funds[4]	– 13 "other" funds

- Most large agencies have at least one IR fund, and many have more than one, for example:
  - Department of Interior has a franchise fund pilot and 4 working capital funds
  - Department of Commerce has a franchise fund pilot and 3 working capital funds

[4] As discussed, the EPA franchise fund is labeled a "working capital fund" and the HHS pilot operates under its "service and supply fund." On the other hand, the Federal Aviation Administration (FAA) has a fund that it labels a "franchise fund." It is not part of the franchise fund pilot program although it operates under similar authority.

58 intragovernmental revolving funds have varying labels and purposes (cont.)

- IR funds were created for a variety of purposes, most frequently to provide common services:
  - 34 IR funds, including 6 franchise fund pilots, are authorized to provide common services required by many federal agencies
  - 24 provide goods or services that are not commonly required
- In addition to the IR funds, there are entities called cooperative administrative support units (CASUs):
  - CASUs are entrepreneurial organizations that provide the full range of support services to federal agencies on a cost reimbursable basis
  - Have provided services since 1986 in those regions of the country with intense federal government activity
  - CASUs generally derive their authority to enter into agreements with other federal entities from the Economy Act
  - Several CASUs have moved to operate under the authority of a franchise fund to make use of provisions more expansive than those of the Economy Act

Funds that perform common services operate under similar legal authorities

- The legal authorities for the 34 IR funds that provide common services generally specify:
  - The means of initial capitalization
  - That funds may be received from clients external to the agency, i.e., "other government/federal agencies" or "other sources"
  - That both payment in advance and payment by reimbursement are allowed; some funds require advance payment and do not permit reimbursement
  - That rates should be set to recover all operational expenses; authority most frequently stipulates the inclusion of annual leave and depreciation as part of expenses to be recovered

Funds that perform common services operate under similar legal authorities (cont.)

- Receipts earned in a fiscal year, i.e., offsetting collections, are a result of the rates charged for services provided
- Most revolving funds are intended to operate on a break-even basis over the long term
- Statutes frequently include the requirement for the periodic payment of any surplus amounts to the general fund of the Treasury at the end of the fiscal year
- However, not all unspent receipts are considered surplus, some are carried over as unobligated balances, including amounts reserved to recover the costs of accrued leave and depreciation

Funds that perform common services operate under similar legal authorities (cont.)

- 22 of 34 IR funds that provide common services have some additional discretion in determining unobligated balances that may be retained (see appendix 3):
  - 16 allow the head of the agency to determine what level of funding meets the needs of the fund
  - 6 do not specifically stipulate the return of surpluses to Treasury
  - While some funds have the discretion described above, GAO has stated that operating with deficits or surpluses continuously for periods of several years is not consistent with the funds' statutory objective of operating on a break-even basis over the long term[5]

[5] See U.S. General Accounting Office, OPM's Revolving Fund Policy Should Be Clarified and Management Controls Strengthened, GAO/GGD-84-23 (Washington, D.C.: Oct. 13, 1983).

Funds that perform common services operate under similar legal authorities (cont.)

- Several funds were given explicit authority to accumulate reserves (see appendix 3):
  - 8 IR funds, including 5 of the franchise fund pilots, have the authority to charge for "a reasonable operating reserve"
  - 8 IR funds, including 5 of the franchise funds pilots, have authority to retain "up to 4 percent of total annual income for acquisition of capital equipment and financial management improvements"
  - Labor, Justice, and the National Archives and Records Administration have other explicit language allowing reserves for specified purposes

Interior Franchise Fund

Organizational history:

- Began operating in October 1996
- Two primary components, Minerals Management Service (MMS) and National Business Center (NBC)
- MMS contained GovWorks, two CASUs, and U.S. Films & Video; all existed prior to the creation of the franchise fund
- NBC included a few of its services under the franchise fund, most stayed under the working capital fund
- In 2001, CASUs left IFF to go to the Treasury franchise fund
- In October 2002, those NBC services under the franchise fund were moved to the working capital fund
- GovWorks accounted for over 95 percent of all IFF revenues as of October 1, 2002, and is currently the primary business line under the franchise fund
- Through fiscal year 2002, IFF subject to an audit of its financial statements at the fund level

Interior Franchise Fund: Implementation of Business Principles

Principle 1: Services–provide only common administrative support services

- GovWorks:
  - Provides acquisition services
  - OMB defines procurement as inherently governmental in nature
  - Some clients do not have a procurement office; others choose to use GovWorks rather than their own procurement office
  - Supports project from contract initiation to contract close-out and helps client choose appropriate vendor to perform work

Principle 2: Organization–clearly defined organizational structure

- GovWorks:
  - Separate organizational coding structure in general ledger accounting system for transactions

Interior Franchise Fund: Implementation of Business Principles (cont.)

Principle 3: Competition—not sheltered or a monopoly

- GovWorks:
  - Accounts for and pays MMS for support services
  - Pays the Department of the Interior for an allocation of departmental overhead
  - In fiscal year 2002, received 95 percent of revenue from customers external to Interior and 5 percent of revenue from customers within Interior
  - Has competitors who also offer procurement services

Interior Franchise Fund: Implementation of Business Principles (cont.)

Principle 4: Self-sustaining/Full Cost Recovery—fees established to recover full cost

- GovWorks:
  - Management reports and financial statements indicate the collection of revenues in excess of what would normally be considered full costs, as permitted by law
  - Design of the managerial costing processes identifies full (direct and indirect) costs of operations
  - Service fees are set at a fixed percentage of contract amounts in order to recover the full cost of operations, including support services provided by MMS and overhead allocated by the Department of the Interior; however,
  - Has not regularly calculated the unit costs of outputs, i.e., actual unit cost per contract dollar awarded, which could be useful as a measure of performance

Interior Franchise Fund: Implementation of Business Principles (cont.)

Principle 5: Performance Measures–should have comprehensive performance measures to assess services

- GovWorks:
  - Prepares trend analysis on revenues and expenses in addition to total number and dollar amount of awards and funding documents
  - Hired KPMG Consulting to conduct customer survey; June 2000 report assessed clients' opinions on satisfaction with services, marketing strategies, interest in potential future service offerings

Principle 6: Benchmarks–cost and performance measures against competitors

- GovWorks:
  - Has cost and performance data that could be compared to competitors, but GovWorks staff said that information is not available from entities with similar functions

Interior Franchise Fund: Implementation of Business Principles (cont.)

<u>Principle 7: Adjustments to Business Dynamics</u>–ability to adjust capacity and resources up and down

- <u>GovWorks:</u>
  - Experienced dramatic growth in revenue and workload since fiscal year 1997 and projected through fiscal year 2007
  - Actively marketing in print and electronic media using the "GovWorks" brand name in its franchise awareness program
  - Has hired new staff to meet increasing workloads and has developed training
  - Reviewing core business processes and documenting procedures to facilitate consistent delivery of services

Interior Franchise Fund: Implementation of Business Principles (cont.)

Principle 8: Surge Capacity–resources to provide for peak business periods, capital investments, and new starts

- GovWorks:
  - Legal requirement for advance payments allows cash flow for hiring of additional employees as needed
  - Flexibility limited by constraints on using private contractors to perform inherently governmental acquisition management
  - Combined reserve balance as of June 2003 is about $6.3 million
  - Desired “operating reserve” would total $16 million, and would include funds intended to:
    - Pay for ordinary/necessary operating costs that may be incurred
    - Offset any future short-term operating losses
    - Replace existing capital equipment/software
    - Pay employees’ annual leave earned since business line inception
    - Cover costs of shutting-down business line (if ever necessary)
  - Desired “reserve for improvements” would total $3 million, and would include funds intended for improvements in the financial, procurement, and business management systems

Interior Franchise Fund: Implementation of Business Principles (cont.)

Principle 9: Cessation of Activity–reasonable notice to customer before eliminating service

- GovWorks:
  - No elimination of service has occurred; clients reportedly not affected by movement of NBC services to working capital fund
  - Franchise fund management has the freedom to not enter into additional contracts with clients
  - Operating reserve includes funds intended to cover 1 year of costs to perform shut-down if service is eliminated
  - Believes that if the franchise fund was not reauthorized, it could continue successful operations if it were authorized as a working capital fund; would not want to operate under the authority of the Economy Act

Principle 10: Voluntary Exit–customers should be able to exit

- GovWorks:
  - Procurement contracts are discrete, customers can leave at contract's end
  - Has many return clients but does not document whether all customers return

Commerce Franchise Fund

Organizational History

- Began operating in October 1996
- Two primary business components, OCS and National Oceanic and Atmospheric Administration's (NOAA) Administrative Service Centers (ASC)
- Both existed prior to creation of the franchise fund
- NOAA's ASCs left franchise fund in 1998
- Department requested adding another business line in 2001, but OMB did not authorize it
- Currently, OCS is the only business line in the franchise fund
- OCS was subject to financial audits at the fund level for fiscal years 1997 and 1998, and at the department level for fiscal years 2001 and 2002 (no audits for fiscal years 1999 or 2000)

Commerce Franchise Fund: Implementation of Business Principles

Principle 1: Services–provide only common administrative support services

- OCS:
  - Provides information technology infrastructure support services
  - Uses subcontractors to provide some services such as disaster data recovery, computer maintenance, and technical support

Principle 2: Organization–clearly defined organizational structure

- OCS:
  - Separate organizational coding structure in general ledger accounting system for transactions
  - Is the only business line in the franchise fund and its internal management reports clearly lay out its revenues and types of costs

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 3: Competition–not sheltered or a monopoly

- OCS:
  - Accounts for and pays for its own support costs
  - Pays the Department of Commerce for an allocation of departmental overhead
  - In fiscal year 2002, received 57 percent of revenue from customers external to Commerce and 43 percent of revenue from customers within Commerce
  - Has competitors who also offer information technology support services

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 4: Self-sustaining/Full Cost Recovery–fees established to recover full cost

- OCS:
  - Management reports and financial statements indicate the collection of total revenues in excess of what would normally be considered full costs, as permitted by law
  - Design of the managerial costing processes identifies full costs (direct and indirect costs) of operations
  - Activity-based pricing model is used to estimate future costs to be recovered and fees for each output are set at a level that is expected to recover full costs; however,
  - Has not calculated the actual unit costs of outputs to determine if fees are sufficient to recover full costs for each type of output, which could be useful as a measure of performance

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 5: Performance Measures–should have comprehensive performance measures to assess services

- OCS:
  - Prepares trend analysis on number and types of customers and related revenues
  - Positive feedback from customers but has not used a formal mechanism to evaluate its performance

Principle 6: Benchmarks–cost and performance measures against competitors

- OCS:
  - Has developed cost-based fees for units of output delivered to customers that could be compared against those of competitors, but OCS staff stated that competitors' fees for similar units of output are difficult to obtain

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 7: Adjustments to Business Dynamics–ability to adjust capacity and resources up and down

- OCS:
  - Has had recent declines in number of customers and revenues, but OCS expects revenues to remain stable through fiscal year 2005
  - In fiscal year 2002, INS accounted for 77 percent of external revenue and 44 percent of total revenue
  - Not focused on actively marketing; management relies on satisfied customers and referrals to find new customers that can be served with existing systems
  - Has subcontractors available to meet short-term requirements and to avoid carrying excess capacity
  - Computer processors sometimes operate near capacity but processors could be added to serve additional customers

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 8: Surge Capacity–resources to provide for peak business periods, capital investments, and new starts

- OCS:
  - Received authority to retain up to 4 percent of total annual income for capital/improvements starting in fiscal year 1999
  - Reserve balance at end of fiscal year 2002 is approximately $500,000, or about 1 percent of total revenues earned since receiving retained earnings authority
  - Currently developing a capital plan

Commerce Franchise Fund: Implementation of Business Principles (cont.)

Principle 9: Cessation of Activity–reasonable notice to customer before eliminating service

- OCS:
  - Has never eliminated a service unless requested by the client
  - Service agreements allow either party to terminate the agreement, usually with 120 days advance notification
  - Would probably return to the Department of Commerce working capital fund if it were not reauthorized as a franchise fund (as such, would not have the explicit authority to retain 4 percent of total annual income for capital/improvements)

Principle 10: Voluntary Exit–customers should be able to exit

- OCS:
  - Has had several clients leave when client IT applications were no longer supportable; the clients chose new applications and new IT support providers

Reauthorization Issues

- Managers cited benefits of working under the franchise fund label:
  - Believe it energized operations and provided opportunities for growth
  - CASUs have joined franchise funds to make use of provisions more expansive than those of the Economy Act
- Ability to retain 4 percent of total annual income generally perceived as a benefit of a franchise fund, although our discussions with franchise fund managers and others have raised several considerations:
  - There is not a clear understanding of the provision allowing the 4 percent retention of total annual income, although many interpret it as a reserve for capital/improvements and therefore maintain a separate operating reserve
  - The need for capital reserves depends on the amount of capital assets used in providing services
  - There is evidence that franchise fund pilots have not been able to retain 4 percent of total annual income and indications that charging rates that would allow a 4 percent reserve might make their prices uncompetitive

Reauthorization Issues (cont.)

- If reauthorized, longer-term authorization for selected franchise fund pilots would be beneficial:
  - Annual reauthorizations create unease for current and potential clients concerned with stability
  - Adding new business lines unlikely until future operations are more certain
- If reauthorized, additional changes might be helpful for agencies:
  - Clarification of relationship between reserve of "4 percent of total annual income" for capital/improvements and operating reserve could avoid differing interpretations
  - Ability to receive advances helpful, but <u>requirement</u> for advance payment reduces flexibility to work with some clients
  - Additional human capital flexibilities, such as in hiring practices, might be helpful, according to one franchise fund manager

Reauthorization Issues (cont.)

- If not reauthorized, many services being provided under franchise funds probably would continue under other authorities:
  - All the business lines we examined were in existence before becoming part of the franchise fund
  - Several business lines have left the franchise funds and continue to provide services
  - OCS would probably return to the existing working capital fund
  - GovWorks would want authorization to be a working capital fund
- Proposed revisions to OMB's Circular A-76 regulations would have affected IR funds, but final version does not:
  - A-76 provides rules for competition of commercial activities, including many of the common services provided by IR funds
  - November 2002 proposed revisions would have required customer agencies to compete their "contracts"(i.e., inter-service support agreements) over $1 million
  - Final version issued May 29, 2003, omitted this provision

Concluding Observations

- Longer-term authorization for selected pilot funds would be helpful to the operation of the funds and their clients
- Nonetheless, neither the legal authority nor the operation of franchise funds makes them unique from other IR funds
- The “attraction” to the franchise fund label seems to be the explicit ability to retain 4 percent of total annual income-need legal authority but not franchise label to do that
- For any IR fund, agencies may request additional legal authorities, and Congress may expand those authorities if it wishes to do so (and has done so in the past)
- A governmentwide authorization is not necessary

Concluding Observations (cont.)

- In considering the provision of franchise-type authorities to individual IR funds, criteria include:
  1. Operations should adhere to OMB's 12 business principles
  2. Managerial cost accounting process should be in place that can account for the full unit costs of outputs produced
  3. Annual or periodic independent audit should be considered <u>at the fund level</u> to ensure the reliability of the fund's financial information
  4. Additional elements to consider:
     – Top level commitment at agency
     – Strong leadership at the fund level
     – Well-developed business-like operating philosophy
     – Commitment of staff to customer service

12 Business Operating Principles

Operating Principle	OMB Description
1) Services	The enterprise should only provide common administrative support services.
2) 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.
3) Competition	The provision of services should be on a fully competitive basis. The organization's operation should not be "sheltered" or be a monopoly.
4) 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).
5) Performance Measures	The organization must have a comprehensive set of performance measures to assess each service that is being offered.
6) Benchmarks	Cost and performance benchmarks against other "competitors" are maintained and evaluated.
7) 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.
8) Surge Capacity	Resources to provide for "surge" capacity and peak business periods, capital investments, and new starts should be available.
9) 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.
10) 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.
11) FTE Accountability[a]	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.
12) Initial Capitalization[a]	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 the CFO Council

[a]We did not examine these principles in our case study of the Interior and Commerce franchise fund pilots.

Authority to Retain Unobligated Balances—Franchise Pilots and Comparable IR Funds

	Department/ agency	Fund name/bureau	Secretarial discretion to retain unobligated balances[a]	Explicit authority to retain operating reserve	Explicit authority to retain up to 4% of total annual income	Other explicit authority to retain balances
1	Commerce	Franchise fund, Departmental Management		X	X	
2	Interior	Franchise fund, Minerals Management Service		X	X	
3	Treasury	Franchise fund, Departmental Offices		X	X	
4	VA	Franchise fund, Departmental Administration		X	X	
5	EPA	Working capital fund (WCF)		X	X	
6	Transportation	Administrative services franchise fund, FAA		X	X	
7	Commerce	WCF, Census		X		
8	Homeland Security	WCF, Departmental Management		X		
9	Justice	WCF, General Administration			X	X
10	CIA	Central services WCF			X	
11	Labor	WCF, Departmental Management				X
12	National Archives and Records Administration	Records center revolving fund				X
13	Agriculture	WCF, Executive Operations	X			
14	Commerce	WCF, Departmental Management	X			
15	Commerce	WCF, National Institute of Standards and Technology	X			
16	Defense—Military	Buildings maintenance fund	X			
17	Energy	WCF, Departmental Administration	X			
18	HHS[b]	HHS service and supply fund, Program Support Center	X			
19	Housing and Urban Development	WCF, Management and Administration	X			
20	State	WCF, Administration of Foreign Affairs	X			
21	Interior	WCF, Bureau of Reclamation	X			
22	Interior	WCF, Departmental Management	X			
23	Interior	WCF, United States Geological Survey	X			
24	Treasury	WCF, Departmental Offices	X			

(Continued From Previous Page)

	Department/ agency	Fund name/bureau	Secretarial discretion to retain unobligated balances[a]	Explicit authority to retain operating reserve	Explicit authority to retain up to 4% of total annual income	Other explicit authority to retain balances
25	Transportation	Transportation Administrative Service Center, Office of the Secretary	X			
26	VA	Supply fund, Departmental Administration	X			
27	Equal Employment Opportunity Commission	Education, technical assistance and training revolving fund	X			
28	GSA	WCF, General Activities	X			
29	GSA	Federal buildings fund, Real Property Activities	X			
30	GSA	General supply fund, Supply and Technology Activities	X			
31	GSA	Information technology fund (FEDSIM), Supply and Technology Activities	X			
32	International Assistance Programs	WCF, Agency for International Development	X			
33	Legislative Branch	Fedlink program and Federal research program, Library of Congress	X			
34	Office of Personnel Management	Revolving fund	X			
Total			**22**	**8**	**8**	**3**

Source: GAO analysis

Note: Shading highlights franchise fund pilots.

[a]Most of these funds are required to deposit in miscelleneous receipts of the Treasury amounts in excess of the needs fo the fund; however, in some cases this requirement is not specifically stipulated.

[b]The HHS franchise fund pilot operates under the statutory authority for the HHS Service and Supply Fund, which is not required to return excess to the Treasury. There is no explicit authority specifying an operating reserve or the retention of up to 4 percent of total annual income, although HHS franchise fund officials believe that they are allowed this authority according to Chief Financial Officers Council, *Federal Franchise Pilots: Pilot Program Implementation Guide* (Washington, D.C.: April 1996).

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