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NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION

NOAA's "Corporate-Costs" Process Needs Improvement

Final Audit Report No. STD-14427-3-0001/March 2003

PUBLIC RELEASE

Office of Audits, Science & Technology Audits Division

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

March 10, 2003

MEMORANDUM FOR: Sonya G. Stewart
Chief Financial Officer/Chief Administrative Officer
National Oceanic and Atmospheric Administration

FROM: Johnie E. Frazier Johnnie Frazier

SUBJECT: NOAA's "Corporate-Costs" Process Needs Improvement
Final Audit Report No. STD-14427-3-0001

Attached is our final report on NOAA's corporate costs process. We note in our report that NOAA officials have already made improvements in managing corporate costs, but we also make a number of recommendations to further improve the process. Specifically, NOAA should (1) improve the methods by which corporate costs are funded by the line offices, (2) develop formal policies and procedures for the corporate-costs formulation and distribution process, (3) establish a charter for the Corporate Board, and (4) develop an aggressive corrective action plan to address relevant corporate-costs related problems identified in this report and addressed in previous major studies. The executive summary begins on page i, and recommendations begin on page 15.

We appreciate the level of attention and careful consideration that you and your staff took to address our findings and recommendations, and we have noted, throughout the report, the actions NOAA has taken to improve the corporate costs process since the completion of our fieldwork and issuance of our draft report. Steps discussed in your response to our draft report should provide a firm foundation for developing an audit action plan.

In accordance with DAO 213-5, please provide us with the audit action plan for our review and concurrence addressing all of the report recommendations within 60 days of this memorandum. Should you need to discuss the contents of this report or the audit action plan, please call me at (202) 482-4661, or Michael Sears, Assistant Inspector General for Auditing on (202) 482-1934.

Attachment

cc: Acting Deputy Chief Financial Officer/Director of Budget

Director, Audit, Internal Controls, and Information Management Office

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EXECUTIVE SUMMARY

NOAA uses the term "corporate costs" to refer to the costs associated with NOAA's central executive management and policy direction, as well as those associated with the centrally controlled administrative services provided by the Office of Finance and Administration (OFA). NOAA funds these costs from a variety of sources, including appropriated funds from the Procurement, Acquisition and Construction account, and the Program Support budget activity under the Operations, Research and Facilities account, line office appropriated funds through assessments and direct billings, and an overhead charge that is applied to NOAA's reimbursable projects as a percentage of the total reimbursements. OFA has overall responsibility for NOAA's corporate-costs process. Within OFA, the Office of Budget's Business Management Fund Division is responsible for managing the corporate costs. In FY 2000, NOAA spent more than $153 million for activities identified as corporate costs, of which $92.5 million came from either assessments or direct billings to the line office appropriations; $50 million came from the Program Support appropriation; and $10.9 million from overhead charges applied to NOAA's reimbursable projects.

We conducted a performance audit of the process and practices NOAA used to develop its corporate-costs budgets for FY 2000 and FY 2001 and focused on NOAA's management and funding of costs for centrally controlled administrative services. The objectives of our review were to determine whether (1) the methodologies used to distribute the corporate-costs budget throughout NOAA were systematic and rational, (2) the planning process for developing the annual corporate-costs budget was reasonable, and (3) the issues affecting the corporate-costs process identified in previous studies as needing improvement have been addressed through corrective action.

Our specific findings and recommendations are as follows:

- **NOAA's line office assessment distribution methodology needs to be improved**. NOAA assesses line offices to fund most corporate-costs activities. We found, however, that these assessments were not based on the direct labor methodology prescribed in NOAA's Budget Handbook for corporate-costs distributable elements. Rather, they were based on what could best be described as a hybrid combination of historical practices and direct-labor assessments. Unfortunately, neither NOAA's prescribed direct labor methodology—which was not used—nor its current hybrid practices are appropriate because neither result in a fair and transparent correlation of costs assessed to services provided. FASAB Standard #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, requires that common costs that cannot be directly traced to activities that share the resources must be assigned to activities by reasonable allocations. (See page 5.)

- **NOAA's "direct billing" algorithms are not always equitable and reasonable.** NOAA also funds a portion of the corporate-costs activities by "directly billing" line offices for special services. We found, however, that the costs borne by the line offices did not necessarily correlate to the level of services received. A proper direct billing methodology should trace the services provided to the actual associated costs and bill the specific entity benefiting from those services. Under NOAA's system, various allocation methodologies are used to distribute the "direct" costs to the line offices, some of which may not have derived any benefit from the services at issue. Those methodologies apply different algorithms for each of the services provided. We found that these algorithms were not always, equitable, reasonable or appropriate and did not consistently and fairly correlate costs to services received. Consequently, there was little, if any, assurance that the line offices were paying an appropriate and reasonable portion of the costs. FASAB Standard #4 states that if costs cannot be directly traced to services or assigned on a cause-and-effect basis, they should be allocated on a reasonable and consistent basis. (See page 7.)

- **NOAA has no formal planning process for developing the annual corporate-costs budget.** As a result, there is no assurance that the process has the internal controls necessary to ensure that the corporate-costs budget is properly developed, and consistently managed, and that costs are effectively contained. Specific and well-defined policies and procedures—which are currently lacking—are an integral component of effective internal controls. (See page 10.) Also, we found that the Corporate Board NOAA established to provide oversight of the corporate-costs process still does not have a formal charter. A formal, well-defined charter would be a key component of an effective internal control system that will address the agency's cost containment responsibilities and outline the Board's membership, duties, objectives, and activities, and make clear which issues the Board must address. Without a charter, there is little, if any, assurance that the Board will consistently and effectively address the critical corporate-costs issues facing NOAA. (See page 10.)

- **Although some corrective actions have been initiated, NOAA has been slow to address the corporate-costs problems identified in previous studies.** We are aware of several internal NOAA studies conducted between 1996 and 1998, which resulted in recommendations that address accountability and operational issues affecting the corporate-costs process. These studies recommended improvements such as tying assessments to services received, increasing the involvement of top NOAA officials in the process, and enhancing customers' involvement in the process. In 2000, the National Academy of Public Administration (NAPA), at NOAA's request, completed a review of NOAA's budget and financial management processes. NAPA's report comments on accountability issues regarding the corporate costs and incorporates previously defined issues from the above-mentioned studies by making consolidated recommendations to address the problems. Although NOAA made efforts to identify problems and solutions regarding the corporate-costs process through these various studies, it has not moved forward with all necessary improvements. However, NOAA has responded to some of the recommendations in these studies by taking several important actions including creating and filling a position of Deputy CFO/Director of Budget at the SES level; establishing a Corporate Board; involving the line offices in the budget process; establishing a Budget Office division to oversee the corporate-costs process; restructuring NOAA's budget in order to fund executive management and policy direction (EXAD) from Program Support appropriation funds and not from line office assessments; and issuing revised indirect cost policies and procedures. Additionally, NOAA has contracted with a private firm to define the central administrative services provided to line offices and their associated service costs so that NOAA may use Activity-Based Costing as a methodology for distributing the costs. NOAA has also taken action to establish a "Business Management Fund," which is structured as, and commonly referred to as, a working capital fund, as the financing mechanism for the costs. Despite this progress, NOAA has more to do. In addition to addressing the issues outlined in this OIG report, NOAA should develop a formal plan to address, as appropriate, each of the unresolved NAPA report recommendations. The NAPA recommendations were designed to improve accountability, ensure a clear and formal requirements process, develop a methodology to correlate costs to services provided, and convert non-service activities currently funded by assessments to appropriations-based funding. (See page 13.)

We recommend, beginning on page 15, that the NOAA Chief Financial Officer/Chief Administrative Officer ensure that the following actions are undertaken:

1. Improve the methods by which corporate costs are funded by the line offices by:

    a. Developing and implementing appropriate distribution methodologies and related algorithms that fairly and transparently correlate costs to services received and meet the requirements contained in FASAB Standard #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* for costs that cannot be directly attributed to specific line offices. The methodologies should be fully documented in NOAA's directives system.

    b. Using fee-for-service billing for those cost elements where that method is practical and appropriate. The process for such billings should be documented in NOAA's directives system.

2. Improve the planning process for developing the corporate costs by:

    a. Developing formal policies and procedures that detail the NOAA corporate-costs formulation and distribution process and that outline the purpose, objectives, roles, responsibilities, key events, and timeline. The policies and procedures should be fully documented in NOAA's directives system.

    b. Establishing a charter for the Corporate Board. The charter should define the Board's authority, mission, objectives, and membership, as well as membership criteria and responsibilities, including responsibilities for containing costs.

3. Include in the audit action plan in response to this audit report specific steps to address corporate-costs-related problems identified by this report and addressed in the March 2000 NAPA report. The steps should identify the problems, responsible officials, and dates for completion, and specify appropriate tasks to resolve the problems. The action plan steps should address how NOAA will improve accountability to customers, ensure a clear and formal requirements process, develop a methodology to correlate costs to services provided, and convert, if appropriate, any remaining non-service activities, including any non-service activities identified as a result of the ABC costing analysis, funded by assessments to appropriations. The audit action plan will be monitored to ensure that all remedial tasks identified are completed.

As noted above, NOAA has taken steps to establish a working capital fund as recommended in the NAPA report. However, a working capital fund will not of itself solve all of the problems with NOAA's corporate-costs process unless the issues identified in this report are addressed and corrective actions taken.

* * * *

Overall, NOAA concurred with the findings and recommendations identified in the report and was pleased that the OIG had recognized some of the actions NOAA had taken to improve its corporate costs process. However, NOAA officials stated that the report does not adequately acknowledge all of the work NOAA has underway and near completion. They stated that many of the problems identified in the report with FY 2000 and 2001 were corrected for the FY 2002 process. In addition, NOAA officials stated that the Business Management Fund Division within the NOAA Budget Office is guided by the principals of an Activity-Based-Management concept that will result in the conversion of NOAA's corporate costs from an assessment-based methodology to an activity-based methodology. NOAA officials further stated that they are in the process of developing a clear and formal requirements process for FY 2004, and noted the following key accomplishments:

- An open corporate cost development process where customers participate and support proposals, rather than the prior adversarial nature of corporate costs development;

- A corporate board (the charter is currently under review by NOAA senior management) review process that culminates in final decision early in the fiscal year;

- A funds control process in OFA that includes monthly budget reports, adherence to a Table of Organization encompassing OFA's authorized personnel, and publicly reported year-end closeouts; and

- Completion of a comprehensive Activity Based Costing review of all of OFA's services. This will result in services aligned to customer needs and billed accordingly.

We note that the period of review for the OIG audit of NOAA's corporate costs process was FY 2000 and 2001. In responding to our report, NOAA officials stated that they have taken actions during their FY 2002 corporate costs process to correct many of the issues we discussed with them during our review. We commend NOAA's reported actions and acknowledge that, with these reported changes, accountability should be greatly increased. We will be monitoring progress made on NOAA's audit action plan. Based upon NOAA's comments to the draft report, we have made changes throughout the report where warranted and NOAA's specific comments are included after each finding and recommendation in the report. The NOAA response in its entirety is included as Appendix III to the report.

INTRODUCTION

The National Oceanic and Atmospheric Administration (NOAA) is the largest agency within the Department of Commerce and has a varied and complex set of program responsibilities. NOAA's mission is to describe and predict changes in the Earth's environment and to conserve and manage the nation's coastal marine resources to ensure sustainable economic opportunities.

NOAA uses the term "corporate costs" to refer to the costs associated with its (1) central executive management and policy direction, and (2) centrally controlled administrative services provided by the Office of Finance and Administration (OFA), such as personnel and contracting services that are used by NOAA's line offices. These costs are primarily indirect costs incurred at the NOAA Headquarters level that are distributed to the line offices. NOAA funds these costs from a variety of sources, including appropriated funds from the Procurement, Acquisition and Construction account, and the Program Support Budget Activity[2] under the Operations, Research, and Facilities (ORF) account, line office appropriated funds through assessments[3] and direct billings, and an overhead charge that is applied to NOAA's reimbursement projects as a percentage of the total reimbursements.

OFA has overall responsibility for NOAA's corporate-costs process. Within OFA, the Office of Budget's Business Management Fund Division is responsible for managing the corporate-costs process. For FY 2000, NOAA spent more than $153 million for activities identified as corporate costs, of which $92.5 million came from line office appropriated funds as a result of either assessments or direct billings; $50 million came from the Program Support appropriated funds; and $10.9 million from overhead charges applied to NOAA's reimbursement projects.

NOAA uses a cumbersome process, only partially documented, to develop and fund its corporate-costs budget. For FY 2000, NOAA reported that $50 million in appropriated funds under the Program Support budget activity were used to fund executive direction and policy responsibilities including $11 million for Executive Direction and Administration (EXAD), which included the Office of the Under Secretary and supporting staffs[4]. An additional $10.7 million was obtained from line office appropriated funds through the corporate-costs assessment to pay for EXAD activities in FY 2000.

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[2] Program Support activities provide programs and people within NOAA the administrative and infrastructure support necessary for the programs to meet their missions and for the agency to meet its broader goals. Source: *NOAA FY 2001 Budget Request*

[3] The line offices are assessed the bulk of the corporate costs; however, OMAO and other NOAA offices are assessed a very small amount, about $631,000 or .7% of the total corporate costs assessment in FY 2000.

[4] EXAD, as defined in P.L. 106-113, consists of the Offices of the Under Secretary, the Executive Secretariat, Policy and Strategic Planning, International Affairs, Legislative Affairs, Public Affairs, Sustainable Development, the Chief Scientist, and the General Counsel.

NOAA officials advised that they restructured their budget in FY 2002 in response to Congressional requests. In an attempt to provide a more distinctive linkage of administrative services to NOAA program activities, NOAA realigned the Program Support budget activity to incorporate a Corporate Services subactivity that funds the corporate costs for executive direction and policy formulation and direction activities. NOAA reported that the EXAD activities and policy responsibilities became fully funded out of the Corporate Services Office account and that funding support from the line offices through the corporate-costs assessments is no longer needed. Because many of the financial records for the fiscal year 2002 were still preliminary during the conduct of our audit fieldwork, it was not possible at that time to confirm the source of funds used for EXAD activities during FY 2002.

The second component of NOAA's corporate costs, centrally controlled administrative services, is funded by line office appropriated funds through assessments and direct billings, and by overhead charges applied to NOAA's reimbursable projects. Centrally controlled administrative services are provided or managed by OFA for the line offices and are primarily funded through the assessments. Examples of these services include personnel, budget, grants and acquisition management, facilities, finance, and support for the Administrative Support Centers. The costs also include "common" costs for administering the Workman's Compensation program, providing sign language interpreting and Employee Express services, and paying the Department's Working Capital Fund bill for services the Department of Commerce provides NOAA. The line offices are also "directly billed" for "extra" services, not included in the assessment, that OFA provides line offices. NOAA distributes these "direct billed" services using distribution methodologies that purportedly correlate services provided to costs incurred. For FY 2000, the line offices were assessed $71.5 million and directly billed $8.4 million for the centrally controlled administrative services.

NOAA uses its Management Fund[5] as the financial mechanism to plan, obligate, and account for funds collected from the assessments, direct billings, and overhead charges applied to NOAA's reimbursement projects to pay for NOAA's corporate costs that are not funded by direct appropriation under NOAA's Program Support budget activity. Among other things, this mechanism allows the different sources of corporate cost funding to flow from the source accounts into one location, the Management Fund, where the funds are obligated to pay the myriad costs included in the centrally controlled administrative services and Administrator's Fund[6], a contingency fund set up for unplanned requirements. The Management Fund is not an appropriated fund, is not formally identified in NOAA's annual Budget Request to the President, and is used for

[5] A Management Fund Account is authorized by law to credit collections from two or more appropriations to finance activity not involving a continuing cycle of business-type operations. Such accounts do not generally own a significant amount of assets such as supplies, equipment, or loans, nor do they have a specified amount of capital provided--a corpus. Source: GAO'*s A Glossary of Terms Used in the Federal Budget Process,* GAO/AFMD-2.1.1, January 1993.

[6] The Administrator's fund is a contingency fund previously called the Administrator's Distribution Fund established annually from appropriated funds for and administered by the Administrator, NOAA. It provides the funding for unplanned requirements which could not be foreseen when the budget was presented to Congress. Source: *NOAA Budget Handbook*.

many purposes, one of which is corporate costs. To pay NOAA's FY 2000 corporate costs, a total of $103.4 million flowed through the Management Fund. This amount consisted of $84.1 million in assessment funds ($10.7 million for EXAD, $71.5 million for central services, and $1.9 million for Administrator's Fund), $8.4 million in direct billing funds, and $10.9 million in overhead funds from NOAA's reimbursable projects.

NOAA's Corporate Board is responsible for reviewing and approving the NOAA corporate-costs budget. The members of the Board are the Deputy Under Secretary for Oceans and Atmosphere (Chairman); the Deputy Assistant Administrators of NMFS, NOS, OAR, NWS, NESDIS, and OMAO; and the NOAA Chief Financial Officer (CFO). The NOAA Deputy Chief Financial Officer/Budget Officer (Budget Officer) is not a Board member but serves in an advisory capacity to ensure that the Board's instructions are executable. In FY 2000, the Budget Officer developed a "Corporate-costs Process" schedule for the 2-year period covering FY 2000 and 2001. The schedule is being used as a guide in developing the corporate-costs budget.

The Corporate Board is responsible for approving the amount of corporate-costs funding to be assessed to the line offices and the amounts to be directly billed to the line offices for special services that NOAA officials explained are regularly requested by the line offices. NOAA's Budget Execution and Operations Division assesses the line offices using an allocation methodology and bills the line offices "directly" for additional special services using allocation methodologies unique to each service.

The results of our audit provide details on problem areas we identified with the corporate-costs process, as well as our recommendations to address these problems.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our performance audit were to determine whether (1) the methodologies used to distribute the "corporate costs" throughout NOAA were systematic and rational, (2) the planning process for developing the annual corporate-costs budget was reasonable, and (3) the issues affecting the corporate-costs process identified in previous studies as needing improvement have been appropriately addressed. The scope of our audit focused on management of the corporate-costs process covering the centrally controlled administrative services provided by the Office of Finance and Administration for all of NOAA. The period of review covered FY 2000 and 2001. In addition, although we did not formally review FY 2002 activities, we did confirm that the overall practices used to plan and distribute NOAA's corporate costs in FY 2000 and 2001 were also used in FY 2002.

Our review methodology included interviews with NOAA Headquarters and line office representatives and review of pertinent documents such as NOAA's budgets for FY 2000 and 2001, NOAA's budget submission for FY 2002, the NOAA Budget Handbook, and the National Academy of Public Administration report, *Improving the NOAA Budget and Financial Management Processes*, issued in March 2000. We reviewed NOAA policies for distributing indirect costs, NOAA budget planning and execution documents, OIG audit reports, corporate-costs documentation for FY 2000 and 2001, and any actions taken by NOAA to correct identified deficiencies. We also examined federal guidance and legislation, relevant federal laws, regulations, and guidelines, including the Statement of Federal Financial Accounting Standards Number 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government,* published by the Office of Management and Budget (OMB); the Chief Financial Officers Act of 1990, Public Law 101-576; and OMB Circular A-123, Management Accountability and Control.

We evaluated the adequacy of internal controls related to the development and distribution of NOAA headquarters corporate costs. We found that key steps in the corporate-costs process were not documented, as described in detail in the body of this report. We did not assess the reliability of computer-generated data because such data was not used during our review, and we did not conduct any substantive testing of transactions.

Our audit was conducted in accordance with generally accepted government auditing standards, and was performed under the authority of the Inspector General Act of 1978, as amended, and Department Organization Order 10-13, dated May 22, 1980, as amended. Our audit was conducted from August 2001 through January 2002, at the Herbert Hoover Building in Washington, D.C., and NOAA's Silver Spring Metro Complex in Maryland.

FINDINGS AND RECOMMENDATIONS

Our audit of the NOAA corporate-costs process revealed that the methods NOAA uses to fund corporate costs are not systematic and rational, and that NOAA does not have a formal planning process for developing the annual corporate-costs budget. We also found that NOAA has taken some important corrective actions to improve the corporate-costs process; however, NOAA has been slow to address the problems dealing with the corporate-costs process identified in prior studies.

I. METHODS FOR FUNDING CORPORATE COSTS NEED TO BE IMPROVED

Assessment Distribution Methodology Needs to be Improved

NOAA assesses line offices to fund its corporate-costs activities; however, these assessments are not based on the direct labor methodology prescribed in NOAA's Budget Handbook for corporate-costs distributable elements. Instead, NOAA uses what could best be described as a hybrid combination of historical practices and direct labor assessments, which has no definitive basis and does not conform to FASAB Standard #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*. Unfortunately, neither NOAA's prescribed direct labor methodology—which is not used—nor its current hybrid practices are reasonable or appropriate because there is no fair and transparent correlation of costs assessed to services provided. Standard #4 states that common costs that cannot be directly traced to any one of the activities or outputs that share the resources must be assigned to activities by reasonable allocations.

Agency officials stated that NOAA has not planned or budgeted its corporate costs, or any other indirect costs, in line with established policy because to do so would unfairly burden the line offices that have heavy labor costs—i.e., large staffs. For example, NWS has the highest direct labor costs because it employs about 47 percent of all NOAA employees. Because of this, NWS would pay the largest share of the OFA Human Resources staff costs, which may be reasonable; however, NWS would also pay the largest share of the OFA Grants Management staff costs regardless as to the level of services used. To resolve this inequity, NOAA utilizes a "historical" distribution methodology for all indirect costs, including the corporate costs, agency-wide. However, the basis for this methodology is undocumented, and NOAA was not able to explain the origin of the percentage numbers used in the historical distribution.

NOAA officials stated that if they attempted to use direct labor as a distribution methodology for corporate and other indirect costs, some line offices would be required to pay a higher corporate-costs share than they have been paying but would receive no proportional budget increase to cover the additional expenses. To correct the situation, NOAA asserted that a mass realignment of funds would be necessary throughout NOAA to move corporate and other indirect cost funding from line office to line office so that current programs would not be adversely affected. According to NOAA officials, such a realignment could be labor-intensive, difficult, and confusing. Additionally, NOAA officials have stated that direct labor can shift from year-to-year as projects and priorities change, so that there is a potential that funds would need to be realigned each year. However, even if realigning funds were feasible, NOAA managers assert that using direct labor as a distribution methodology is not always reasonable because use of such a method does not necessarily ensure the most accurate correlation between costs and services received.

Despite these concerns and in an effort to follow its documented policy, NOAA has attempted to bring the corporate-costs assessment in line with the prescribed direct labor distribution methodology. Beginning in FY 2000, NOAA began using a two-tier methodology. The first tier consisted of corporate base costs, which equaled about 96 percent of the FY 2000 assessment, and was allocated to line offices using percentages derived from NOAA's undocumented historical methodology. The second tier, consisting of increases to corporate base costs amounting to 4 percent of the total FY 2000 corporate assessment, was allocated to the line offices using the prescribed direct labor methodology. Table 1 compares the allocation of corporate costs using the two-tier methodology vs. direct labor. Using the prescribed direct labor distribution methodology as a basis of distribution would result in NWS and NOS paying more of the costs and NMFS, OAR, and NESDIS paying less. Since the costs are ultimately allocated to the programs, this allocation process somewhat distorts the costs of the individual NOAA programs.

Table 1: Historical vs. Direct Labor Distribution for FY 2000
Total Budgeted Assessment: $81,530,500*

Assessment Methodology	**NOAA Line Offices**[7]				
	NOS	**NMFS**	**OAR**	**NWS**	**NESDIS**
Direct Labor **	$9,457,538	$18,075,312	$7,158,378	$38,832,977	$6,693,654
Historical Two-Tier	$8,470,900	$20,045,000	$9,811,100	$35,383,200	$7,138,700
Difference	**$986,638**	**($1,969,688)**	**($2,652,722)**	**$3,449,777**	**($445,046)**

* The $81,530,500 is the amount approved by the Corporate Board prior to any increases experienced during the fiscal year.

** Direct labor rate used in this table is based on the direct labor rates applied in FY 2000 as a part of the two-tier methodology.

NOAA officials acknowledged that using either direct labor or the hybrid method as allocation methodologies for all central services is not reasonable and they are moving toward charging for such services on a fee-for-service basis. NOAA has entered into a contract with a consulting firm to develop fee-for-service models for the central administrative services OFA provides line offices. NOAA believes these actions should delineate the path from costs to amount and quality of services received providing the line offices data on which to provide feedback to the servicing organizations. NOAA has stated that the contractor is also working with the Budget Office to develop a

[7] Only the five LOs are listed as they receive the bulk of the assessment. OMAO and other NOAA offices contribute a very small amount, approximately $631,000 in FY 2000, toward the assessment.

methodology to distribute the common costs that cannot be directly charged. NOAA is also seeking legislative approval to establish a Business Management Fund (BMF) that is structured as and commonly referred to as a working capital fund (WCF) and which would be used as the funding mechanism to cover all corporate-costs activities that can be directly charged on a fee-for-service basis. NOAA officials have stated that they will proceed with establishing a fee-for-service basis of charging costs regardless of the outcome of the request to establish the BMF.

NOAA needs to continue its efforts to fully develop and implement a distribution methodology that is transparent, fair, and reasonable, and is in conformance with FASAB Standard #4. We note that the NAPA report recommends that NOAA establish a WCF to establish accountability over the corporate costs by having an oversight body, customer representatives, a charter, and performance objectives. We see the merits in NOAA establishing a WCF and, if properly administered, such a fund could provide more accountability and visibility to the serviced agencies and Congress. With a WCF, NOAA would no longer need to finance the corporate costs through the Management Fund. Additionally, NOAA would be required to produce yearly statements of current assets and liabilities, as well as a schedule of expenditures and reimbursements that should provide improved accountability over the funds. However, before a WCF is established, NOAA must adequately addresses the issues and corrective actions noted in this report.

"Direct Billing" Algorithms Are Not Always Equitable and Reasonable

NOAA also funds a portion of the corporate-costs activities by "directly billing" line offices for special services; however, the costs borne by the line offices do not necessarily correlate to the level of services received. A proper direct billing methodology should trace the services provided to the actual associated costs and bill the specific entity that benefited from those services. Under NOAA's system, various allocation methodologies are used to distribute the "direct" costs to the line offices. Those methodologies apply different algorithms for each of the services provided. We found that these algorithms were not always equitable, reasonable, or appropriate and did not consistently and fairly correlate costs to services received. Consequently there was little, if any, assurance that the line offices were paying an appropriate and reasonable portion of the costs. As previously noted, FASAB Standard #4 states that if costs cannot be directly traced to services or assigned on a cause-and-effect basis, they should be allocated on a reasonable and consistent basis.

NOAA stated that it uses this process to bill the line offices for services that OFA provides on special projects that exceed the services funded by the assessment. For FY 2001, each direct-billed project was supported by an information sheet that outlined the services, the funding, the responsible accountability officer, background information on the special project service, and the algorithm used for distributing the costs. These information sheets were used as the basis for making funding decisions during the corporate-costs decision process.

NOAA stated that the direct billing costs correlated directly to the services provided, similar to a fee-for-service methodology. However, we found that NOAA does not have a system in place to directly track project costs and bill them to the entity that benefits from the project, as would be the case in a fee-for-service environment, but rather NOAA uses algorithms to distribute these costs. The algorithms did not always appear to be rational and equitable because the costs did not always correlate to the services provided.

For example, as noted in Table 2, the Special Employment Program was intended to provide resources to develop, implement, and maintain a NOAA-wide Special Employment Program to assist managers in achieving NOAA affirmative action goals. The algorithm used for this element distributed the costs evenly to each of the five line offices despite the fact that a line office's use of the program was directly proportional to the number of managers in the line office. It is not reasonable to assume that all line offices have the same number of managers and that each should pay the same portion of the costs. Using this methodology suggests there was an inequitable distribution of the costs for this project.

The New Operating Payment Environment element related to the costs incurred by the finance offices in Germantown, MD and the Administrative Service Centers to process payments to vendors. However, the algorithm used to distribute the costs was based on the percentage of line office/program office/staff office personnel. This also is unreasonable, as the number of vendor payments did not appear to have any correlation to the number of line office/program office/staff office personnel.

Other examples in Table 2 used algorithms based on separate historical allocation methodologies, with no direct correlation between services provided and costs incurred. NOAA's descriptions of the historical methodologies, as stated on the information sheets, do not provide a sufficient level of detail for reviewers to determine whether the algorithm is fair and reasonable.

Table 2: FY 2001 Direct Bill Allocation Methodologies

Direct Billed Services (listed on project Information Sheet)	NOAA's Allocation Methodology (listed on project Information Sheet)	OIG Concerns about Methodology
Special Employment Program. Provides resources for the development, implementation, and maintenance of this NOAA-wide Program to assist managers in achieving NOAA affirmative action goals.	Distributed evenly to major line offices.	Algorithm does not appear to relate to the level of services provided to a line office, as staffing and numbers of managers may differ greatly from one line office to another.
SSMC Support Services. Produce resources to complete the restacking efforts for the NMFS and Office of General Counsel on the 15th floor, Silver Spring Metro Center III.	Based on staffing by line office with an additional $100,000 billed to NOS for NOS-specific work.	Algorithm is not based on the benefit conferred by the work. The information sheet explanation shows NMFS and OGC are benefiting offices; however, all the line offices share in the costs.
New Operating Payment Environment. Provides additional resources in finance offices in Germantown, MD, and at the ASCs to maintain the current level of service for making vendor payments via the NOAA Payment System.	Based on percent of line office/program office/staff office personnel.	Algorithm is not based on the benefit conferred by the work; the benefit to the line offices is based on the *number of vendor payments* made for each line office/program office/staff office, not on the percentage of personnel.
Computer Division Contract Costs/Central Info. Tech. Provides funding for a contract in the Computer Division of the Information Technology Center	Historical distribution of costs (staffing in the originating fiscal year). Any additional changes are based on staffing by line office.	Algorithm is not specific, but is based on historical distributions without sufficient description of the basis for the distribution.
Facilities – Audit Support Provides resources to address audit issues relating to real property and personal property.	Based on a historical percent of line office/program office/staff office FTEs.	Algorithm is not specific, but is based on historical distributions without sufficient description of the basis for the distribution.
Indoor Air Quality – SSMC Provides funding for remediation activities at the Silver Spring Metro Center Campus to improve indoor air quality.	Based on historical distribution rates for each line office/staff office.	Algorithm is not specific, but is based on historical distributions without sufficient description of the basis for the distribution.

As a result of the algorithms used, individual line offices may have been billed for more or less than their fair share of the direct bill costs. More importantly, use of the term "direct billing" suggests that the cost could be directly linked to the services provided, which would have precluded the necessity for an algorithm. NOAA needs to determine which of these costs should be billed to specific line offices on a fee-for-service basis and, for those costs that must be allocated, develop a distribution methodology that will clearly and fairly correlate costs to services received and conform to the principles contained in FASAB Standard #4.

NOAA's Response

NOAA officials stated that in FY 2004, they will use Activity-Based Costing to charge their customers for services based upon usage. Additionally, NOAA stated in FY 2002, their Direct Bill process for NOAA changed. The Business Management Fund Division met with the Line Office Chief Financial Officers/Management and Budget Chiefs to discuss the costs and algorithms for the Direct Bill items and they unanimously agreed with the total costs and algorithms used. NOAA stated that the algorithms were equitable, reasonable, and appropriate, and consistently and fairly correlated costs to services received. NOAA stated that the costs and bills are reviewed every year and if alternative billing mechanisms are available that are more accurate, they are adopted. Additionally, NOAA stated that three of the algorithms included in Table 2 of this report were changed for FY 2002.

OIG Comments

The actions NOAA officials state they have taken for FY 2002 should improve the accountability for the direct bill charges and provide a better link between charges and services received. Additionally, the use of Activity-Based Costing, when fully implemented, should more clearly associate services provided with costs when it is fully implemented in FY 2004.

II. FORMAL PLANNING PROCESS NEEDS TO BE ESTABLISHED

Policies and Procedures Are Not Formalized

We found that NOAA does not have formal, documented policies and procedures for managing its corporate-costs process. Without formal policies and procedures, there is no assurance that the corporate costs will be developed and managed in a consistent and equitable manner during each budget cycle. Nor is there any assurance that the information the Corporate Board uses to make decisions regarding the level of funding for corporate costs, including which projects to fund, is reasonable, accurate, or fully supported because there are no formal requirements to create and maintain supporting documentation. According to OMB Circular A-123, Management Accountability and Control, policies and procedures are tools in an agency's internal control system to help program and financial managers achieve results and safeguard the integrity of their programs.

During FY 2000, responsibility for the corporate-costs process was transferred from the Office of Finance and Administration, Management and Budget Division, to the NOAA Budget Office. In an effort to provide accountability over the process, the Budget Officer prepared a one-page "Corporate-costs Process" schedule for the 2-year period covering FY 2000 and 2001. She also provided direction to the appropriate budget officials by e-mail correspondence and meetings. These communications afforded a loose mechanism through which to develop the corporate-costs budget; however, these ad-hoc directions do not have the authority and force held by formal policies and procedures, nor do they provide detailed guidance for staff.

During the corporate-costs budget formulation process, the Budget Office transmits information to the line office budget officials and the Corporate Board members, including tables and charts outlining budget requirements, OFA staff requirements, information about special projects and direct billings, and line office allocations. Because there are no formal policies to direct how the information and data should be arrayed, what information should be captured, or the documentation that should be provided to reviewing officials, the Board has no assurance that the information provided for formulating its decisions is consistent, complete, or accurate. Line office budget officials stated that although the process that began in FY 2000 was more open than in the past, they often did not have sufficient time to review the information supporting the corporate costs prior to meetings. They stated that charts containing cost information changed format from one meeting to another, which caused confusion when they tried to make comparisons. As a result, they were not always able to determine whether the costs were complete and accurate, and were, therefore, not always able to make informed decisions.

There also are no formal policies outlining the level of analysis or communication with the line offices during OFA budget preparation. For instance, there was no requirement to analyze the base costs when preparing the FY 2000 and 2001 budgets for the OFA units. Additionally, there were no formal minutes or notes to record the results from meetings held with NOAA budget officials and the Corporate Board, and no formal notification of the final corporate-costs figures transmitted to the line offices, other than the Allowance Advice. There is, in fact, no requirement to provide any feedback to the line offices regarding the status of the corporate-costs obligations and expenditures once the corporate budget is approved.

Specific and well-defined policies and procedures are an integral component of an agency's internal controls. Formalized policies and procedures are needed to set the control mechanisms that will enable NOAA's corporate-costs process to consistently meet the needs of the agency with input from all involved parties. NOAA's current practices provide a framework for the process, but the framework needs to be filled in. The policies and procedures should detail NOAA's corporate-costs formulation and distribution process and outline the purpose, objectives, roles, responsibilities, key events, and timeline.

Executive Oversight Is Not Defined

The Corporate Board was established for the FY 1999 corporate-costs process to provide oversight of the corporate-costs process, but no charter was created to identify the Board membership, responsibilities, objectives, or activities. A formal, well-defined charter is a needed addition to NOAA's internal controls that will address cost containment issues, outline the Board's membership, responsibilities, objectives, and activities, and make clear which issues the Board must address. OMB Circular A-123 requires agency heads to design management structures that help ensure accountability for results, and a system of good internal controls is key to that structure.

As previously noted, the Board currently consists of the Deputy Under Secretary for Oceans and Atmosphere (Chairman), the Deputy Assistant Administrators of NMFS, NOS, OAR, NWS, NESDIS, and OMAO, and the NOAA Chief Financial Officer. The NOAA Deputy Chief Financial Officer/Budget Officer, while not a member, serves in an advisory capacity to ensure that the Board's instructions are executable. The Board has operated as an executive review board responsible for reviewing corporate-costs documentation, making decisions about what should or should not be funded, and approving the final corporate-costs budget. Board decisions are presented at a series of meetings where presentations and roundtable discussions are held and where Board members have the opportunity to challenge any item in the proposed budget.

However, there is no charter that clearly outlines the responsibilities and focus of the Corporate Board and defines its cost containment responsibilities for NOAA's corporate costs. The Board's responsibilities must be defined and, once agreed upon, a formal charter should be established that clearly describes the Board's structure, membership, and responsibilities.

NOAA's Response

NOAA officials take exception to our statement that there is no assurance that the information the Corporate Board uses to make decisions regarding the level of funding for corporate costs, including which projects to fund, is reasonable, accurate, or fully supported. They also take exception to our assertion that they did not share corporate costs information with the line offices in a timely manner and in a format that is easily understood. NOAA officials stated that they met with line office personnel twice before the Corporate Board meeting and responded to line office requests for documentation and charts so that the process would be more inclusive. They also state that prior to FY 2000, corporate meetings were closed so the new way of developing corporate costs was an education process for all involved. NOAA officials agree that they were severely limited by the lack of accurate and available financial data from FIMA but, in the future, they will be able to utilize both CAMS and Activity-Based Costing software to respond to customer questions on their usage for a particular service provided. NOAA officials also state that formal notification of the corporate-costs figures was provided to the line offices in FY 2002, that they are now formally briefing line offices and providing reports quarterly on corporate costs, and that they returned unused corporate cost funds to the line offices in FY 2001. Additionally, a formal charter is in draft for the Business Management Fund Customer Service Advisory Board, which will replace the Corporate Board. The Advisory Board will hold its first meeting in May 2003.

OIG Comments

We note NOAA's concern over our statements regarding the adequacy of information the Corporate Board uses to make decisions and the sharing of information with line offices. However, we determined during our audit of the corporate-costs process for fiscal years 2000 and 2001, that NOAA had not developed formal policies and procedures to be used by management in order to make funding decisions. Further, there was no formal charter outlining the responsibilities of the Corporate Board in the corporate-costs process. As a result, we concluded that there was no assurance that the information that management used to make decisions regarding the level of funding for corporate costs was reasonable, accurate, or fully supported. Therefore, we reaffirm our position that NOAA needs to establish a formal planning process for its corporate costs including establishment of formal policies and procedures, and definitions of executive oversight so that decisions made are consistent, complete, and accurate. We appreciate that NOAA has acknowledged problems with their corporate-costs planning process and has reported that they have initiated steps to make improvements.

III. CORRECTIVE ACTIONS TAKEN BUT MORE NEEDED

NOAA has recognized many of the problems with its budgetary and financial systems and has commissioned several studies; however, NOAA officials have been slow to take some of the needed corrective actions identified by those studies. Several studies conducted by NOAA internal teams--including a 1996 study of NOAA's overhead, a 1997 study of the budget process, and a 1998 study of the Administrative Support Centers--recommended improvements, such as tying assessments to services received, increasing the involvement of top NOAA officials in the process, and enhancing customers' involvement in the process. In 2000, the National Academy of Public Administration, at NOAA's request, completed a review of NOAA's budget and financial management processes that included eight recommendations. NAPA identified several accountability issues regarding corporate-costs and made one recommendation that also addressed previously identified issues from the above-mentioned studies. Although NOAA has made efforts to identify problems and solutions regarding the corporate-costs process through these various studies, it has not implemented all necessary improvements.

NOAA has taken a number of important steps to address the reported problems with the corporate-costs process. NOAA created and filled a position, which has subsequently become vacant, of Deputy CFO/Director of Budget (Budget Officer) at the SES level with responsibility over the corporate costs process and, as noted previously, contracted with the National Academy of Public Administration (NAPA) to perform a study, completed in March 2000, of NOAA's budget and financial management processes. NOAA also established an executive level Corporate Board to provide oversight and approve the corporate-costs budget, developed an informal structure to guide the corporate-costs planning process, and moved the responsibility for developing and managing corporate costs to the Budget Office. In early FY 2001, the Business Management Fund Division within the Budget Office was formed to manage the corporate-costs process and facilitate communication between NOAA headquarters and line offices. NOAA developed a Table of Organization (TO)[8] for OFA to assist in the development of staffing and projected labor costs. NOAA also stated that it worked with congressional staff members to produce a restructured budget for FY 2002. NOAA officials further stated that the Program Support Budget Activity within the Operations, Research and Facilities account was restructured in the new budget to fully fund EXAD activities with appropriated funds, negating the need for supplemental funding from the line office appropriations through the corporate-costs assessment.

NOAA is currently exploring ways to more equitably distribute corporate costs. NOAA issued interim policies and procedures on indirect costs on September 12, 2000, and updated them in November 2001. Further, NOAA initiated action in FY 2002 so that all corporate-costs non-policy activities and services can eventually be distributed on a fee-for-service basis using Activity-Based Costing[9]. NOAA has hired a contractor to better define the services provided and the associated costs so that line offices can be charged for the services they receive. NOAA officials stated that the contractor is working with the Budget Office to develop a methodology to distribute any common costs that cannot be directly charged. Finally, NOAA has, consistent with the NAPA report recommendations, requested Congressional approval to establish a "Business Management Fund" (BMF), which is structured as a working capital fund (WCF). The WCF will be managed by the Business Management Fund Division.

Although NOAA has taken steps to establish accountability in the corporate-costs process and make it more equitable, it still has more to do. We support NOAA's decision to obtain an independent study by NAPA and agree with the report's recommendations, but NOAA should address the recommendations in this OIG report before it establishes a WCF. We have noted previously that the NOAA Budget Officer, with the cooperation of management officials, has spearheaded recent corrective actions to address the problems with corporate costs. However, in order to ensure that these actions are implemented and the momentum continues, regardless of management changes, NOAA needs to include in its audit action plan in response to this audit report comprehensive steps to ensure that actions necessary to resolve and implement NAPA report recommendations addressing the corporate costs process are clearly defined. The action plan steps should address developing a clear and formal requirements process, instituting a methodology that correlates costs to services provided**,** and converting, if applicable, any remaining non-

[8] The Table of Organization is a tool that maps authorized organization and position data to budgetary information on employees, positions, grades/steps. The Table of Organization will provide OFA management with information on the organization's structure, authorized positions and staffing status, as well as actual and projected labor and benefits costs by position and organizational component.

[9] NOAA plans to use Activity-Based Costing as the costing methodology for directly charging users. ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs. Implementing ABC requires four major steps: (1) identify activities performed in a responsibility segment to produce outputs, (2) assign or map resources to the activities, (3) identify outputs for which the activities are performed, and (4) assign activity costs to the outputs (*FASAB Standard #4, Managerial Cost Accounting Concepts and Standards for the Federal Government.)*

service activities including any non-service activities identified as a result of the ABC costing analysis funded by assessments to appropriations.

NOAA's Response

NOAA officials stated that they plan to complete by April 2003 all actions for the one NAPA recommendation pertaining to corporate costs. They further stated that they are in the process of completing a clear requirements process for corporate costs and that it will be formalized by the spring corporate board meeting.

OIG Comments

We acknowledge that NOAA has taken steps to address the issues identified within the one NAPA recommendation addressing the corporate-costs process. For example, NOAA has taken steps to establish a cost distribution methodology to better associate costs with services provided, and to develop a clear requirements process. However, some of the actions NOAA needs to take to address the NAPA recommendation have not yet been implemented. It is important to formally track these activities until all actions have been implemented.

Recommendations

We recommend that the NOAA Chief Financial Officer/Chief Administrative Officer ensure that the following actions are undertaken:

1. Improve the methods by which corporate costs are funded by the line offices by:

   a. Developing and implementing appropriate distribution methodologies and related algorithms that fairly and transparently correlate costs to services received and meet the requirements contained in FASAB Standard #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* for costs that cannot be directly attributed to specific line offices. The methodologies should be fully documented in NOAA's directives system.

   b. Using fee-for-service billing for those cost elements where that method is practical and appropriate. The process for such billings should be documented in NOAA's directives system.

   NOAA's Response to Recommendations. NOAA concurs with the recommendations.

2. Improve the planning process for developing the corporate costs by:

   a. Developing formal policies and procedures that detail the NOAA corporate-costs formulation and distribution process and that outline the purpose, objectives, roles, responsibilities, key events, and timeline. The policies and procedures should be fully documented in NOAA's directives system.

b. Establishing a charter for the Corporate Board. The charter should define the Board's authority, mission, objectives, and membership, as well as membership criteria and responsibilities, including responsibilities for containing costs.

NOAA's Response to Recommendations. NOAA concurs with the recommendations.

3. Include in the audit action plan in response to this audit report specific steps to address corporate-costs-related problems identified by this report and addressed in the March 2000 NAPA report. The steps should identify the problems, specify appropriate tasks to resolve the problems, identify responsible officials, and include dates for completion. The action plan steps should address how NOAA will improve accountability to customers, ensure a clear and formal requirements process, develop a methodology to correlate costs to services provided, and convert, if appropriate, any remaining non-service activities, including any non-service activities identified as a result of the ABC costing analysis, funded by assessments to appropriations. The audit action plan will be monitored to ensure that all remedial tasks identified are completed.

NOAA's Response to Recommendation. NOAA generally concurs with the recommendation. However, NOAA stated that the March 2000 National Academy of Public Administration report includes as an appendix an aggressive, comprehensive plan that served as a blueprint for necessary corrective actions. NOAA further states that the statement of work for the ABC contract addresses all of the items mentioned specifically in the OIG's recommendation. NOAA officials also state that they already have action plans to address the OIG recommendation and suggest that the OIG recommendation should be revised to state that the existing plans should be monitored.

OIG Comments. We acknowledge that NOAA has taken actions to address ongoing problems but need to see a detailed action plan to resolve ongoing corporate costs problems. The March 2000 NAPA report contains at Appendix B (A Road Map to Comprehensive Improvement), which is a schedule providing a broad sequence of events that could be undertaken in order to implement some of the major NAPA recommendations. The Appendix contains general actions regarding the corporate costs process but does not contain specific tasks to resolve the problems, responsible officials for each task, and specific dates for completing each task. Additionally, the Appendix itself references the agency's development of an action plan that would aid in the implementation of the report recommendations. Without a detailed plan, NOAA does not have a formal activity and reporting mechanism to document the actions required, taken, or planned to address recommendations, nor does it have the basis for an accomplishment report to detail the improvements NOAA has made. Additionally, there is no assurance that ongoing or planned corrective actions will continue.

NOAA states that the statement of work issued for the ABC contract addresses all of the items mentioned in the OIG recommendations; however, a statement of work is not in itself an action plan. We, therefore, reaffirm our finding but have modified our recommendation to allow NOAA to include the detailed tasks from the ABC contract in the audit action plan.

APPENDIX I

ACRONYMS

AA	Allowance Advice
ASC	Administrative Service Center
BMF	Business Management Fund
CAMS	Commerce Administrative Management System
CFO	Chief Financial Officer
DOC	Department of Commerce
EXAD	Executive Direction and Administration
FASAB	Federal Financial Accounting Standards Board
FTE	Full Time Equivalent
LO	Line Office
MB	Management and Budget
NAPA	National Academy of Public Administration
NESDIS	National Environmental Satellite, Data, and Information Service
NMFS	National Marine Fisheries Service
NOAA	National Oceanic and Atmospheric Administration
NOS	National Ocean Service
NWS	National Weather Service
OAR	Office of Oceanic and Atmospheric Research
OFA	Office of Finance and Administration
OGC	Office of General Counsel
OIG	Office of Inspector General
OMAO	Office of Marine and Aviation Operations
ORF	Operations, Research and Facilities
PO	Program Office
SO	Staff Office
SSMC	Silver Spring Metro Center
TO	Table of Organization
WCF	Working Capital Fund

APPENDIX II

GLOSSARY OF TERMS[1]

ACTIVITY BASED ACCOUNTING – ABC focuses on the activities of a production cycle, based on the premises that (a) an output requires activities to produce, and (b) activities consume resources. ABC systems use cost drivers to assign costs through activities to outputs. The ABC cost assignment is a two-stage procedure. The first stage assigns the costs of resources to activities and the second stage assigns activity costs to outputs. Implementing ABC requires four major steps: (1) identify activities performed in a responsibility segment to produce outputs, (2) assign or map resources to the activities, (3) identify outputs for which the activities are performed, and (4) assign activity costs to the outputs (*FASAB Standard #4, Managerial Cost Accounting Concepts and Standards for the Federal Government).*

ADMINISTRATOR'S FUND – A contingency fund previously called the Administrator's Distribution Fund established annually from appropriated funds for and administered by the Administrator, NOAA. Provides the funding for unplanned requirements which could not be foreseen when the budget was presented to Congress.

ALLOWANCE ADVICE – The official notification by the Budget Officer, NOAA, to the line/staff office that obligations may be incurred up to stated annual amounts for each appropriation and the Management Fund.

APPROPRIATION – An authorization by an act of Congress that permits Federal agencies to incur obligations and to make payments out of the Treasury for specified purposes. An appropriation usually follows enactment of authorizing legislation. An appropriation act is the most common means of providing budget authority, but in some cases the authorizing legislation itself provides the budget authority.

BASE BUDGET – The cost of performing the same services or conducting the same program in the budget year as is planned for the current year. Normally, the only differences between the base budget and the current year budget are costs which cannot be avoided or which are nonrecurring.

CENTRAL ADMINISTRATIVE SUPPORT – Provides administrative services and assistance for all elements within NOAA in such areas as personnel, finance, procurement, warehouse, mail service and housekeeping functions. These two elements of EXAD are combined for rate calculation and cost distribution.

COMMON SERVICES – Those centrally administered services that are common to all NOAA line/staff offices, and financial management centers. Individually, the bills for these items are small, and the vendors numerous. They cover such items as postage, certain telephone services, certain building services, payments to the Department of Labor for employee's compensation for injuries while on duty, etc. It has been found more economical to process payment for these items from a single fund and is also easier to manage. The costs are distributed to all NOAA tasks.

[1] Source is the NOAA Budget Handbook, unless otherwise indicated.

CORPORATE COSTS – Costs and expenditures associated with NOAA's central executive management and policy direction, as well as those costs associated with centrally-controlled administrative services provided by the Office of Finance and Administration. (NOAA commonly-used definition)

EXAD – Executive Direction provides agency-wide leadership for NOAA, is responsible for developing overall agency goals and objectives, provides overall direction and evaluation of NOAA programs, etc.

FEE FOR SERVICE – Term used when there is a direct correlation between costs and services received. Fees are established for the services provides by an organization.

FIMA – NOAA's financial management system encompasses both the budget planning subsystem and the accounting subsystem. Both planned and actual costs and obligations are thereby available for meeting internal and external reporting requirements.

LINE ITEMS - The first level distribution of the major program elements of an entity program. It is the lowest level of data required to be presented in the formal documents of the Department's program budgeting system. It is also the lowest level at which the full budget request is displayed in budget justifications to the Congress.

MANAGEMENT FUND ACCOUNT – A Management Fund Account is authorized by law to credit collections from two or more appropriations to finance activity not involving a continuing cycle of business-type operations. Such accounts do not generally own a significant amount of assets such as supplies, equipment, or loans, nor do they have a specified amount of capital provided--a corpus. Source: GAO'*s A Glossary of Terms Used in the Federal Budget Process,* GAO/AFMD-2.1.1, January 1993.

PERSONNEL SERVICES – Amounts associated with regular pay for permanent employees, regular pay for other than permanent employees, other personnel compensation (i.e., overtime, night work differential), leave surcharge, and special personnel services payments (i.e., shore leave earned, compensatory leave earned).

WORKING CAPITAL FUND - A Working Capital Fund is a revolving fund that operates as an accounting entity. In these funds, the assets are capitalized and all income is in the form of offsetting collections derived from the fund's operations and available in their entirety to finance the fund's continuing cycle of operations without fiscal year limitation. A working capital fund is a type of intragovernmental revolving fund. Source: GAO's *A Glossary of Terms Used in the Federal Budget Process,* GAO/AFMD-2.1.1, January 1993.

UNITED STATES DEPARTMENT OF COMMERCE
National Oceanic and Atmospheric Administration
CHIEF FINANCIAL OFFICER/CHIEF ADMINISTRATIVE OFFICER

NOV 26 2002

MEMORANDUM FOR: Johnnie Frazier
Inspector General

FROM: Sonya G. Stewart Sonya Stewart

SUBJECT: OIG Draft Report: NOAA's "Corporate Costs" Process Needs Improvement, Draft Report No. STD-14427

Thank you for the opportunity to review and comment on the draft report addressing NOAA's process for managing corporate costs.

Overall, we concur with the findings and recommendations identified in the report. In fact, we appreciate the Office of Inspector General's (OIG) acknowledgment and endorsement of the actions that NOAA had already taken in FY 2002 to improve the corporate costs process. Since our current action plan addresses all of the issues raised in the report, we view the report as a validation of our efforts. However, we are somewhat disappointed in that the report does not adequately acknowledge and document the work already underway and, as of today, is near completion. We request that given the time that elapsed between completion of field work (January) and issuance of this draft (October), that where practicable, this report be updated. NOAA developed an action plan on FY 2000 to address many of the problems with its corporate costs processes in FY 2000 and FY 2001. Our action plan called for implementation as soon as possible, with implementation of final action plans completed by the second quarter of FY 2003.

Again, NOAA appreciates the opportunity to comment on the draft report. Our response to the specific findings and recommendations in the report are attached.

Attachment

NOAA Response to OIG Draft Report:
NOAA's "Corporate Costs" Process Need Improvement

GENERAL COMMENTS:

Overall, we concur with the findings and recommendations identified in the report. In fact, we thank the Office of Inspector General for endorsing actions that NOAA has already taken in FY 2002 to improve the corporate costs process. Since our current action plan addresses all of the issues raised in the report, we see the report as a validation of our efforts. However, we are somewhat disappointed in that the report does not adequately acknowledge the work already underway and, as of today, is near completion. Many of the problems identified with NOAA's corporate costs processes in FY 2000 and FY 2001 were planned to be addressed in FY 2002, with final action plans completed by the second quarter of FY 2003.

As background, it must be understood that changes to improve the corporate costs process were self-initiated by NOAA several years ago. In the past, the Office of Finance and Administration (OFA) Management and Budget (M&B) Division provided policy guidance and staff support to the Chief Financial Officer/Chief Administrative Officer (CFO/CAO), and was responsible for managing the budget and finance functions of NOAA's administrative operations. OFA M&B also served as the primary focal point within OFA for the management and coordination of all budget, financial management, strategic planning, and administrative activities internal to OFA.

In September 2000, OFA underwent a realignment to bring the M&B Division functions more in line with priorities, and future directions, primarily by creating a customer-based service organization. With the creation of the position of Deputy Chief Financial Officer (DCFO)/ Director of Budget, the OFA M&B Division function and responsibilities were placed under the DCFO.

In October 2000, the OFA M&B Division was restructured and became the Business Management Fund Division (BMFD) within the NOAA Budget Office. The Division is guided by the principals of an Activity-Based-Management concept that will ultimately result in the whole-scale conversion of NOAA's corporate costs from an assessment based methodology to an activity based methodology.

Some key accomplishments in this area include:

- An open corporate cost development process where customers participate and support proposals, rather than the prior adversarial nature of corporate costs development;

- A corporate board (the charter is currently under review by NOAA Senior management) review process that culminates in final decisions early in the fiscal year;

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- A funds control process in OFA that includes monthly budget reports, adherence to a Table of Organization encompassing OFA's authorized personnel, and a publicly reported year-end closeouts.

- Completion of a comprehensive Activity Based Costing (ABC) review of all of OFA's services. This ABC review serves as the underpinning of NOAA's Business Management Fund, and formed the structure that will allow OFA to move from a organizationally-based budget to a functionally-based fee-for-service budget. The end result will be services aligned to customer needs and billed accordingly. OFA's activities will be traceable from both a cost standpoint as well as overall performance.

In addition to changing the methodology of the corporate costs budget to one of fee-for-service, we have successfully executed the current budget of over $150 million for three consecutive years. In FY 2000, the budget ended in a surplus of $1.7 million, which was redistributed to the Line Offices. In FY 2001, a surplus of $712.9 thousand was redistributed to the Line Offices. And, in FY 2002, early closeout figures indicate OFA executed under-budget and has carryover justification's pending with the corporate board. Prior to FY 2000, OFA's end of year budget was not reported, nor was it spent within the planned amount. This effort required developing a "back to basics" management philosophy, which includes monthly budget reporting and changing the culture in the organization to one of fiduciary responsibility and control.

In FY 2001, as part of NOAA's budget restructuring effort, OFA converted its non-service activities previously funded by assessments to appropriations. In FY 2002, costs that were not clearly service in nature were funded with appropriated funds subject to the annual appropriations process. Finally, the BMFD is in the process of developing a clear and formal requirements process for FY 2004.

Our following specific comments follow.

Executive-Summary:

Paragraph one, sentence two cites the sources of funds for NOAA's corporate costs. It omits the Procurement, Acquisition and Construction Account.

Introduction:

Page 2, paragraph one states, " . . . NOAA realigned the Program Support budget activity to incorporate a Corporate Services Office that funds the corporate costs for executive direction and policy formulation and direction activities." There is no Corporate Services Office. Corporate Services is a line item in the budget.

Page 2, paragraph one, last sentence states, "Because many of the financial records for the fiscal year 2002 are still preliminary, it was not possible to confirm the source of funds used for EXAD activities during FY 2002." This draft OIG report was issued on October 7, 2002, which is FY 2003. On October 1, 2002, the financial records for FY 2002 were no longer preliminary and the sources of funds used for EXAD activities during FY 2002 can easily be confirmed. EXAD did not use Corporate Assessment funds in FY 2002. NOAA appreciates the fact that on October 7th, closeout numbers were preliminary, but we will be happy to provide you with updated information to support this report.

Page 3, paragraph two, second sentence describes the members of the Corporate Board and includes the Line Office Assistant Administrators. The Line Office members are the Deputy Assistant Administrators.

OIG FINDINGS:

I. Methods For Funding Corporate Costs Need To Be Improved

In October 2001(FY 2002), NFA began implementing Activity-Based Costing (ABC). In FY 2004, NFA will use ABC to charge their customers for services based upon usage.

In FY 2002, the Direct Bill process for NOAA changed. For each Direct Bill item, an Accountability Officer prepared a Fact Sheet to describe the costs and identify an appropriate algorithm. The BMFD hosted meetings with the Line Offices to discuss the costs and algorithm for each Direct Bill. The algorithms were equitable, reasonable, and appropriate, and consistently and fairly correlated costs to services received. Each Line Office unanimously agreed with the total costs and the algorithms used. No Line Office was charged for a service unless they received a benefit.

Page 7, paragraph three, third sentence states, "Under NOAA's system, various allocation methodologies are used to distribute the "direct" costs to the Line Offices, some of which may not have derived any benefit from the services at issue." However, in the Direct Bill process, we do not charge Line Offices for services if they do not receive them.

Page 8, paragraph three, sentence two states that the algorithm used to distribute the costs for the New Operating Payment Environment element was based on, "the percentage of line office/ program office/staff office personnel." It should read: "In FY 2002, the New Operating Payment Environment Direct Bill was charged based upon number of accounting transactions. Absent the availability of formal cost accounting data, this methodology is more than reasonable for NOAA."

Page 9, Table 2: FY 2001 Direct Bill Allocation Methodologies, has several factual errors:

- SSMC Support Services: The draft report states that these costs were, "based on staffing by line office with an additional $100,000 billed to NOS for NOS-specific work." In FY 2002 the Direct Bill for SSMC Support Services for restacking in SSMC3 was charged based upon occupancy, an algorithm agreed to by the corporate board.

- New Operating Payment Environment: As mentioned previously, Table 2 reflects that costs for the New Operating Payment Environment were based on the, "percent of line office/program office/staff office personnel." In FY 2002, the New Operating Payment Environment Direct Bill was charged based upon number of accounting transactions.

- Indoor Air Quality – SSMC: Table 2 states that costs were based on, "historical distribution rates for each line office/staff office." In FY 2002, the Indoor Air Quality Direct Bill was charged based upon occupancy.

We request that your report note the following information: all of the algorithms were unanimously agreed upon by the Line Office Chief Financial Officers/Management and Budget Chiefs. Every year the costs and bills are reviewed, and if there are alternative billing mechanisms available, that are more accurate, NFA has adopted those changes in every instance. NFA recommends you correct the inaccuracies and incorporate the above sentence.

II. Formal Planning Process Needs To Be Established

NOAA's corporate costs are formally briefed at quarterly reviews and reports are provided to all Line Offices. In FY 2001, unused corporate cost funds were returned to the Line Offices. A formal charter is in draft for the BMF Customer Service Advisory Board, which will replace the Corporate Board. The BMF Customer Service Advisory Board will hold its first meeting in May 2003.

Page 10, paragraph two, sentence three states that there is "...no assurance that the information the Corporate Board uses to make decisions regarding the level of funding for corporate costs, including which projects to fund, is reasonable, accurate, or fully supported .. ." This statement is inaccurate. In FY 2002, the Line Offices requested briefings on certain new initiatives. Detailed information was provided to the Line Offices for these initiatives, and shared with the OIG staff. For the remaining initiatives, the Line Offices were provided information that explained the cost of the initiative. All Line Office questions were answered and all requested documentation was supplied. It is a true statement that, at that time, NFA was severely limited by the lack of accurate and available financial data in FIMA (now replaced by CAMS) as well as the lack of activity and service data (soon to be available); however, in the future, NFA will be able to utilize both CAMS and its ABC software to respond to customer questions on their usage by a particular service provided. In FY 2002, NFA responded with the available information and tools at hand. All questions were answered and all available information was provided to satisfy

Line Office requests. While customers would prefer that corporate services come at a zero cost, that information, which would have satisfied all customers, is not available in either system of methodology.

Page 10, the last paragraph implies that corporate costs information is not shared with Line Offices in a timely manner or that the information is not shared in a format that is easily understood. This is conjecture, not fact. In FY 2002, Line Office budget officials were provided with documentation two weeks prior to the Corporate Board meeting. Two meetings were held with these officials before the Corporate Board meeting to provide them with information they requested and to provide charts that they requested. Specific charts were developed at their request. Similar information will also be provided to the Line Office CFOs/M&B Chiefs before the FY 2003 meetings. The pre-briefings are held with the CFOs/M&Bs of each Line Office before the Corporate Board meeting. This is a process NFA initiated to be more inclusive of Line Office CFO/M&Bs and to ensure full vetting prior to Corporate Board. Prior to FY 2000, the corporate meetings were closed door, and no pre-briefs were provided. NFA opened the process to multiple participants, provided the information deemed useful at the time, and provided additional information as questions and input were received from the CFO/M&Bs. The charts are difficult to follow because the budget is complex, and many were reviewing the information for the first time; it was an education process for all involved.

Page 11, paragraph one, sentence three states that there was "... no formal notification of the final corporate-costs figures transmitted to the line offices, other than the Allowance Advice." In FY 2002, formal notice was given for the final corporate-costs figures transmitted to the Line Offices.

III. Corrective Actions Taken But More Needed

Page 12, paragraph one, last sentence states, "Although NOAA has made efforts to identify problems and solutions regarding the corporate-costs process through these various studies, it has not moved forward with all necessary improvements." The draft OIG report stresses the NAPA report and suggests that NOAA needs to fully implement the NAPA recommendations. This leads the reader to believe that there are NAPA recommendations which remain undone, which is not true for those that apply to Corporate Costs. NAPA made a total of nine recommendations to NOAA, eight of which are beyond the scope of corporate costs. NOAA has completed actions on seven of the eight non-corporate costs related recommendations, and significant progress has been made on the remaining recommendation dealing with organization culture. All actions have been completed or are planned to be completed by April 2003 for the one recommendation pertaining to corporate cost. NFA is in the process of completing a clear "requirements" process. This action will be formalized by the spring corporate board meeting when we move formally into the new fee-for-service environment. NOAA would appreciate specifics from the OIG on actions stemming from earlier studies that it believes remain undone, or this information should be reported in a context where the reader can get a clear sense of the actions completed by NOAA as well as remaining actions.

Page 13, first paragraph: The report states that NOAA requested an "initial cash corpus of $5,000,000" for the Business Management Fund. This wording is outdated. The current proposed language in the FY 2003 President's budget does not include this cash corpus. A copy of this language is in the attached presentation.

OIG RECOMMENDATIONS:

We recommend that the NOAA Chief Financial Officer/Chief Administrative Officer ensure that the following actions are undertaken:

1. Improve the methods by which corporate costs are funded by the Line Offices by:

    A. Developing and implementing appropriate distribution methodologies and related algorithms that fairly and transparently correlate costs to services received and meet the requirements contained in FASAB Standard #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government* for costs that cannot be directly attributed to specific Line Offices. The methodologies should be fully documented in NOAA's directives system.

    B. Using fee-for-service billing for those cost elements where that method is practical and appropriate. The process for such billings should be documented in NOAA's directives system.

NOAA Response: NOAA agrees with this recommendation and had already initiated actions for implementation prior to the OIG review.

A. In December 2000, NFA requested the Corporate Board approve resources to begin working on a fee-for-service ABC project. Funds were not provided but NFA worked within its base allocation to continue the project. In October 2001, NFA awarded a contract to design and implement Activity-Based Costing (ABC). This approach will allow for a direct correlation between costs and services rendered. The contract is on schedule and final deliverables are planned for December, 2002.

B. As indicated above, an ABC approach will allow NOAA to use fee-for-service billing as appropriate. In FY 2004, OFA will use ABC to charge their customers for services based upon usage.

2. Improve the planning process for developing the corporate costs by:

    A. Developing formal policies and procedures that detail the NOAA corporate-costs formulation and distribution process and that outline the purpose, objectives, roles, responsibilities, key events, and timeline. The policies and procedures should be fully documented in NOAA's directives system.

B. Establishing a charter for the Corporate Board. The charter should define the Board's authority, mission, objectives, and membership, as well as membership criteria and responsibilities, including responsibilities for containing costs.

NOAA Response: NOAA agrees with this recommendation and actions were already underway for its implementation prior to the OIG review.

A. Policies and procedures that detail the NOAA corporate-cost formulation and distribution process and that outline the purpose, objectives, roles and responsibilities, key events, and timelines are in process. This will be completed by the May 2003 formal corporate board meeting.

B. A formal charter is in draft for the BMF Customer Service Advisory Board, which will replace the Corporate Board. The BMF Customer Service Advisory Board will hold its first meeting in May 2003.

3. Develop an aggressive corrective action plan to address corporate-costs-related problems identified by this report and addressed in previous major studies. The plan should identify the problems and include appropriate tasks to resolve the problems, responsible officials, and dates for completion. The action plan should address how NOAA will improve accountability to customers, ensure a clear and formal requirements process, develop a methodology to correlate costs to services provided, and convert any non-service activities funded by assessments to appropriations. The plan should be monitored to ensure that all remedial tasks identified are completed.

NOAA Response: Generally, NOAA agrees that corrective action plans help to drive progress in difficult areas. As such, an aggressive, comprehensive plan was developed in response to the March 2000 National Academy of Public Administration report. This report and the blue print for action in the appendix was created in coordination and at the request of the current NOAA DCFO. The plan has served as a blueprint for necessary corrective actions for the past three years. In addition, the statement of work for the ABC contract addresses all of the items mentioned in the OIG's recommendation specifically. While we agree, generally, in this recommendation, given we already have an action plan, what specifically is the OIG looking for? It is unclear what other actions NOAA must undertake to address this recommendation. All of this information was available, and it is unclear why another (third to be exact) plan should be developed. We suggest monitoring existing plans for execution would be a more appropriate recommendation for NFA.