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GAO

United States General Accounting Office

Report to the Honorable Bud Shuster
House of Representatives

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FEDERAL WORKFORCE

Revised Factors to Compare Government and Contractor Costs Are Appropriate



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

General Government Division

B-221426

January 24, 1986

The Honorable Bud Shuster
House of Representatives

Dear Mr. Shuster:

This is in response to your letter dated October 10, 1985, in which you expressed concerns about the recent revisions by the Office of Management and Budget (OMB) of Circular A-76, Performance of Commercial Activities. The circular requires government agencies to compare the cost of performing a function using federal employees to the cost of performing the work using a contractor in order to determine the most economical means of obtaining support services. Specifically, you were concerned about the appropriateness of (1) increased cost factors for federal employee fringe benefits, (2) eliminating costs for one-time physical inventories, and (3) increased tax rates.

We interviewed responsible OMB and Office of Personnel Management (OPM) officials to determine the reasons for changing the A-76 cost factors and the appropriateness of those changes. We also reviewed laws and OPM reports relating to the cost factors, the circular, and its related handbook. Our work was performed in accordance with generally accepted government auditing standards during November and December 1985.

We concluded that the increases in fringe benefit costs were appropriate, that one-time costs for physical inventories were not eliminated, and that changes in the tax computation table were appropriately made to reflect more up-to-date data on taxes being paid by selected private industries. These matters are discussed in more detail below. We did not address fringe benefit cost factors that did not change.

Fringe Benefit Costs

In August 1985, OMB increased the cost factors for federal employee benefits from 27.30 percent of pay to 35.75 percent of pay as shown in table 1.

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Table 1: Fringe Benefit Factors

Element	(Percent of pay)	
	Previous factor	Revised factor
Retirement	20.40	27.90
Health and life insurance	3.70	4.70
Other benefits ^a	1.90	1.80
Medicare	1.30	1.35
Total	27.30	35.75

^aIncludes workmen's and unemployment compensation, severance pay, bonuses, and awards.

Retirement Costs

The revised factor represents the most recent estimate of the government's share of the cost of the civil service retirement system reported to the Congress by OPM. In accordance with requirements of Public Law 95-595, OPM reports annually to the Congress on the status and cost of the civil service retirement system. OPM's estimate of retirement costs is dependent on numerous factors, including the demographic characteristics of the workforce, and assumptions about future pay raises, inflation, and interest rates. The previous A-76 retirement factor was adopted in 1979 and needed to be updated to reflect changes in factors affecting the cost estimate. The revised retirement factor included changes in workforce demographics and updated economic assumptions used by OPM to determine the system's cost in its May 1985 report to the Congress. Because the rate can be quite variable (i.e. it was 29.5 percent in May 1984), we recommended¹ to OMB that the rate be annually reviewed and updated. OMB specified in the revised circular that the rate would be adjusted annually based on OPM's determinations.

Federal employees hired since December 31, 1983, are covered by social security, and the Congress is considering alternative retirement programs for them. Until a new program is established, OMB has decided to use the same factor (27.9 percent) for determining the retirement cost for these new employees. However, once the new program is adopted and its costs are determined, OMB will have to establish and maintain separate cost factors for the employees in the two retirement programs.

Insurance Costs

The new factor for health and life insurance (4.7 percent of pay) reflects the increased cost of health benefits. According to OPM, the government's

¹Letter to the Administrator, Office of Federal Procurement Policy, Office of Management and Budget, dated January 17, 1984.

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share of the average annual health benefit premium in 1984 was \$1,102 per employee which represented 4.4 percent of the average salary (\$25,211) of federal employees. The life insurance factor was unchanged at 0.3 percent of pay.

Medicare Cost

This factor was increased to 1.35 percent which is the employer's tax for medicare for 1985 as prescribed by the Social Security Amendments of 1977 (Public Law 95-216). The tax is scheduled to be increased to 1.45 percent in 1986.

Physical Inventories

You were concerned that the revised circular eliminated from cost comparisons the cost to the government for performing physical inventories required in connection with a transfer of material to a contractor. Instructions on physical inventory costs, which were previously in the "Other Costs" section of the preceding cost comparison handbook, are now contained in the "Material Related Cost" section of the current handbook. Page IV-38 of the current handbook states that "For purposes of the cost comparison, only the one-time cost associated with transferring material to a contractor will be included (physical inventory, packing, crating, transportation, etc.)." [Underscoring supplied.] The costs of physical inventories, therefore, are to be included in cost comparisons.

Tax Rates

The changes in the tax computation table in the cost comparison handbook were made to update the tax rates (as a percent of sales) for selected industries. According to OMB, the new tax rates were developed from information provided by the Internal Revenue Service on a sample of corporation tax returns.

An analysis of the tax rate changes for the 135 industries listed in the tax computation table showed that 67 industries' tax rates decreased, 58 increased, and 10 were unchanged. The overall average tax rate for the 135 industries increased from 1.976 percent to 2.008 percent of sales.

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As requested by your office, we did not obtain agency comments on this report. As arranged with your office, copies of this report are being sent to Representative James V. Hansen; the Director, Office of Management and Budget; and the Director, Office of Personnel Management. Copies will be made available to other interested parties on request.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director