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United States General Accounting Office

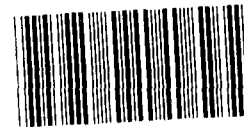
GAO

Report to the Chairman, Committee on
Post Office and Civil Service, House of
Representatives

December 1987

FEDERAL WORKFORCE

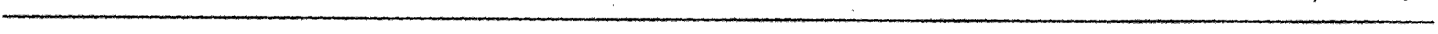
Provisions for Comparing Government and Contractor Retirement Costs Should Be Changed



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GAO/GGD-88-25



General Government Division

B-221426

December 17, 1987

The Honorable William D. Ford
Chairman, Committee on Post Office
and Civil Service
House of Representatives

Dear Mr. Chairman:

This is in response to your June 1, 1987, request concerning the appropriateness of the revisions to Office of Management and Budget (OMB) Circular A-76 made by Transmittal Memorandum #4 dated October 29, 1986. The circular sets forth the procedures that agencies must follow when comparing the cost of performing work under contract with commercial sources with the cost of performing the same work with government personnel and facilities. The October 1986 revisions required that thrift savings plans and the Old Age, Survivors, and Disability Insurance (OASDI) portion of social security be excluded from estimates of government and contractor retirement system costs in the cost comparison studies.

We interviewed OMB officials to determine why Transmittal Memorandum #4 was issued. We also reviewed the applicable provisions of the Civil Service Retirement Act, as amended (5 U.S.C., ch. 83), and the Federal Employees' Retirement System (FERS) Act of 1986 (Public Law 99-335, as principally codified in 5 U.S.C., ch. 84) to determine whether the October 1986 revision to Circular A-76 was consistent with these laws. Our work was performed during October 1987 in accordance with generally accepted government auditing standards.

We found that the October 1986 revision operates in such a way that the resultant A-76 cost comparisons unduly favor contractors over agencies' in-house operations. This occurs because all contractor employees are covered by OASDI, but only those federal employees who are covered by FERS are under OASDI. Most federal employees are currently covered by the Civil Service Retirement System (CSRS) and have no OASDI coverage from their federal employment.¹ Since OASDI costs are excluded from the cost comparison figures but CSRS costs are not excluded, contractors have a greater portion of their retirement costs excluded than do agencies.

¹The social security system includes two components: OASDI, which provides monthly benefits to eligible participants, and Medicare, which provides health insurance protection beginning at age 65. All federal employees, whether in CSRS or FERS, are covered by Medicare.

With the establishment of FERS, federal employees hired after December 31, 1983, are covered by a combination of (1) a pension program, (2) a thrift savings plan,² and (3) OASDI. Because FERS is new, more federal employees are covered by CSRS than by FERS. As of January 1, 1987, about 2.2 million federal employees were covered by CSRS, while about 600,000 were in FERS. By contrast, all employees of a commercial contractor are covered by OASDI, and may also be covered by a thrift savings plan and/or pension plan as well.

OMB's basis for its instructions in Transmittal Memorandum #4 lies in its interpretation of the applicable sections of the FERS Act. Section 307 of the FERS Act provides that

[T]he normal cost percentage . . . of the Federal Employees' Retirement System shall be used to value the cost of the System for all purposes in which the cost of the System is required to be determined by the Federal Government, including any comparisons between the cost of performing commercial activities under contract with commercial sources and the cost of performing those activities using Government facilities and personnel.

The term "normal cost percentage" is defined in section 8401(23) of title 5, United States Code, as

[T]he entry-age normal cost of the provisions of the [Federal Employees' Retirement] System which relate to the Fund, computed by the Office [of Personnel Management] . . . and expressed as a level percentage of aggregate basic pay. [Underscoring added.]

The term "Fund" is defined in section 8401(6) of Title 5, United States Code, as

[T]he Civil Service Retirement and Disability Fund under section 8348 [of Title 5, U.S.C.].

OMB concluded from these statutes that because OASDI and thrift savings plan benefits do not derive from the Civil Service Retirement and Disability Fund, they must not be included in the "normal cost percentage" used for cost comparisons. Thus, costs associated with these benefits were excluded from the Circular A-76 cost comparison process for both the contractor and federal employees. Since all CSRS costs as well as the pension portion of FERS are payable from the Fund, OMB required these

²CSRS-covered employees may participate in the thrift plan but there are no government contributions for these employees and, thus, no cost to the government.

costs to be included in the cost comparison. In view of the language of these statutes, we cannot disagree with OMB's interpretation of the law or its resultant instructions in Transmittal Memorandum #4.

However, it remains that the application of these provisions of the FERS Act results in inequitable cost comparisons. The effects of the revision on A-76 cost comparisons can be illustrated by a current Department of Army review of base industrial support services at Fort Sill, Oklahoma. In a letter dated October 19, 1987, to Senators David Boren and Don Nickles, and Representative Dave McCurdy responding to their concerns about the accuracy of the Fort Sill cost comparison, we said Army officials estimate that excluding OASDI and thrift savings plan costs from their comparison resulted in a net understatement of \$1.6 million in the actual cost of contracting for these services. Including all retirement costs along with using more current wage rates³ would have changed Army's decision to contract for support services. There are 470 federal civilian employees currently working in this area at Fort Sill.

Recognizing the unfairness of the situation, OMB is seeking a legislative change that would correct the problem by including all government and contractor retirement costs in the comparison. By letters dated June 24, 1987, to the President of the Senate and the Speaker of the House of Representatives, OMB submitted a legislative proposal to Congress to effect the necessary change. A copy of OMB's proposal appears as an appendix to this report. Enactment of this legislation will, in our view, eliminate the disparate treatment of retirement costs by amending the FERS Act to require that all such costs, regardless of their source, be included in Circular A-76 comparisons.

We discussed this report with OMB officials, and they concurred with its contents.

³ Army used wage rates from a January 1985 Department of Labor wage survey for comparison with estimated January 1988 federal wage rates. A January 1987 survey showed wages had increased by 3.5 percent.

As arranged with your office, copies of this report are being sent to the Chairman, Subcommittee on Human Resources; the Director, Office of Management and Budget; and the Director, Office of Personnel Management. Copies will also be made available to other interested parties upon request.

Sincerely yours,

Roslyn S. Kleeman

Roslyn S. Kleeman
Senior Associate Director

OMB's Legislative Proposal to Require the Inclusion of Thrift Plan and OASDI Costs in Performing Cost Comparisons

A BILL

To amend section 307 of the Federal Employees Retirement System Act of 1986.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 307 of the Federal Employees Retirement System Act of 1986 is amended to read, as follows:

"Sec. 307. Use of 'Normal-Cost Percentage.'

Notwithstanding any other provision of law, the normal-cost percentage (as defined by section 8401(23) of Title 5, United States Code, as added by this Act) of the Federal Employees' Retirement System shall be used to value the cost of the Retirement Fund for all purposes in which the cost of the System is required to be determined by the Federal Government. For any comparisons between the cost of performing commercial activities under the contract with commercial sources and the cost of performing those activities using Government facilities and personnel, the cost of the System shall include the cost of the Retirement Fund as specified above, along with the cost of the thrift plan and social security."

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