



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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FEDERAL PERSONNEL AND
COMPENSATION DIVISION

B-205580

FEBRUARY 8, 1982

The Honorable Alexander M. Haig, Jr.
The Secretary of State

Dear Mr. Secretary:

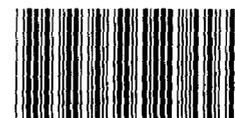
Subject: Computation of Cost-of-Living Allowances
for Federal Employees in Foreign Areas
Could Be More Accurate (FPCD-82-24)

We have completed our review of the methodology used to compute cost-of-living allowances (COLAs) for Federal personnel. We made this review because Federal personnel have raised concerns about the appropriateness of that methodology. This report summarizes our findings and recommends improvements which would make COLA payments more accurate.

Certain deficiencies in State's data collection and computation practices may result in COLA payments that are not accurate. We found that State did not insure that the data it collected accurately reflected the living patterns of Federal personnel, that living pattern data was not always used as intended, that State did not adjust base area prices to reflect changes that occurred between foreign and base area surveys, and that State did not weight sale prices in its COLA computations.

The Department of State administers a COLA program for Federal civilian employees stationed in foreign areas. The Office of Personnel Management (OPM) and the Department of Defense (DOD) administer COLA programs for Federal civilian employees in nonforeign areas and for uniformed personnel in foreign and nonforeign areas, respectively.

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COLAs computed by State, DOD, and OPM are based on prices of a market basket of more than 160 goods and services in the foreign or nonforeign area compared with prices of a similar market basket in the base area (Washington, D.C., for the State and OPM COLAs and the continental United States for the DOD COLA). The administering agencies average the prices and divide the foreign or nonforeign average prices by the base area average prices to obtain a ratio. These item price ratios are weighted by the relative importance of the expenditures they represent. The weights used are derived from the consumer expenditure survey made by the Bureau of Labor Statistics, Department of Labor. Price surveys are made at least annually in the COLA areas, and the administering agencies revise the COLA rates after receiving the annual survey data. For foreign areas, State and DOD also revise the COLAs periodically to reflect changes in currency exchange rates.

The agencies also make living pattern surveys in foreign and nonforeign areas to identify retail outlets Federal personnel most frequently use and the relative importance of each source of supply.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to analyze and identify inconsistencies in administering the COLAs and to find ways of improving methodologies used to compute COLAs. We did not examine the makeup of the market basket, nor did we verify the prices collected. We made our review during calendar year 1981.

At the Department of State's allowances staff office in Rosslyn, Virginia, where policies are set and the COLAs for civilian employees are computed, we interviewed responsible officials and reviewed and analyzed State's policies, procedures, and methodologies used to set the COLA rates. We also visited seven field locations in Germany and Japan. We selected these areas because (1) they contained a large number of personnel who receive COLA (a total of about 9,000 civilian employees) and (2) we could observe in these locales a representative cross section of COLA data collection procedures used by State. In Germany and Japan, we interviewed the responsible officials to determine how surveys are made, how price data are obtained and analyzed,

and how the retail price and living pattern data are reported to headquarters. We also received technical advice from personnel at the Bureau of Labor Statistics.

Our work was performed in accordance with our Office's current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions."

LIVING PATTERN SURVEYS DID NOT ALWAYS
ACCURATELY REFLECT PURCHASING PATTERNS
AND SURVEY RESULTS WERE SOMETIMES IGNORED

State did not insure that the data it collected accurately reflected the purchasing patterns of civilian employees in the COLA areas. Also, contrary to the intent of the living pattern surveys, local officials sometimes did not use the results to select retail outlets where price surveys were made.

The intent of the living pattern surveys is to identify the retail outlets most frequently used and the relative importance of various sources of supply--retail, Government facilities, or goods brought to the post. Data collectors obtain prices for the market basket of goods and services from the outlets frequently used by Federal employees. Certain weights for the index calculations are derived from the living pattern surveys, and the surveys also provide data on food consumption patterns, use of local transportation, and use of domestic servants at the post.

State requests that a living pattern survey be made whenever a substantial change occurs in employee living patterns at the post. State instructs field offices that, when a survey is appropriate, they should send living pattern questionnaires to Federal civilian employees of all U.S. agencies at the post. Only employees who have been at the post for 6 months or more need to be surveyed. For posts with a large number of civilian employees, the field offices may send the questionnaires to a sample of about 150 employees.

In Germany, State officials usually made living pattern surveys annually, but their procedures did not insure representative samples of eligible Federal civilian employees. In Frankfurt, for example, State officials distributed questionnaires only to the 185 employees who worked at the U.S.

consulate. State did not survey any of the approximately 2,000 eligible DOD civilian employees in the Frankfurt area.

In Tokyo, U.S. Embassy officials are responsible for making the living pattern survey. Although the survey was made annually, the information collected was not used as a basis for selecting retail outlets for the price survey. Instead, the price surveys were made in the same outlets as in prior years. Moreover, the latest survey did not represent all Federal civilian employees in the Tokyo area. The 170 surveyed employees all worked at the Embassy. At least 32 eligible employees working elsewhere in Tokyo were not included in the survey.

STATE DID NOT ADJUST
FOR PRICE SURVEY TIMELAGS

State did not adjust base area prices to reflect changes that occurred between foreign and base area surveys. Using unadjusted base area prices could result in inflated or understated cost-of-living indexes.

The Bureau of Labor Statistics makes price surveys for the COLA program in Washington, D.C., during January, May, and September, and the price data is used by State, DOD, and OPM in computing base area prices. About one-half of the price surveys for State are not made during the same months as are the Washington price surveys. Thus, a timelag of 1 to 2 months exists for some areas. For example, when a price survey is made in a foreign area in March, the resulting cost-of-living index is based on a comparison with base area prices collected in the preceding January. If the base area prices increased, due to inflation, during the timelag period and no adjustment has been made, the resulting index would be higher than it should be. On the other hand, if the base area prices decreased and no adjustment has been made, the resulting cost-of-living index would be too low.

Base area prices could be adjusted by use of the price change measured by the consumer price index (CPI); however, because housing costs are not included in State's COLA program but are paid through a separate allowance, housing costs would have to be removed from the CPI. The Bureau of Labor Statistics provided us with an adjusted Washington, D.C., CPI, excluding housing cost items which State deemed irrelevant to its COLA program. We applied this adjustment

to State's cost-of-living indexes for eight foreign locales where timelags existed. The adjusted indexes for all eight locales were from 1.7 to 2.2 percentage points lower than the official indexes derived by State and used to calculate the COLAs for these locales.

A weakness in using the CPI is that it reflects living patterns of the urban population, whereas the Federal COLA program is based, in part, on urban population living patterns and, in part, on living patterns of Federal uniformed personnel and civilian employees. Thus the rate of price change measured by the CPI may be slightly different from the rate reflected in successive COLA price surveys. In view of this possible difference, instead of using the CPI, State could adopt one of the following alternatives:

--State could, as OPM does now, instruct field installations to collect price data in January, May, or September to correspond to price collection in Washington, D.C.

--State could coordinate with DOD and OPM to ask the Bureau of Labor Statistics to increase its pricing schedule in the base area from three times a year to four times a year. Thus, no matter when field activities collected price data, there would never be more than a difference of 1 month between base area and COLA area prices.

STATE DID NOT WEIGHT SALE PRICES

State could improve its COLA computation by weighting prices of items and services on sale. When sale prices were reported on the retail price surveys for Washington, D.C., or foreign areas, State averaged the sale prices with regular prices. This method may not properly reflect Federal employees' purchasing patterns.

A complete retail price survey includes six prices for each item and service--typical, substitute, and economy prices from each of two retail outlets--which are averaged. If one of the six prices is a sale price, then that price would be averaged with the other five regular prices, without regard to the relative volume of purchases made at the sale and regular prices.

Clothing, household furnishings, and automobile maintenance items and services are frequently on sale in the Washington area, but an official from State claimed that sales are less frequent or nonexistent in the COLA areas. Furthermore, Federal employees in the Washington area or in COLA areas where sales can be found may purchase a large proportion of some items and services--such as televisions, washing machines, suits, tires, and engine tuneups--on sale and purchase relatively few of them at regular prices. These sale prices could be weighted to reflect the proportion of purchases made at the reduced prices. This would require the collection and processing of additional data to derive the weights, possibly through adding a data element to the living pattern questionnaire.

CONCLUSIONS

Because of deficiencies in State's methodology to compute COLA, the accuracy of the allowances is unknown. Field officials did not use scientific survey procedures to collect information on where Federal employees shop. The survey results were not used to select the retail outlets for data collection. State did not adjust for, or minimize, timelags between base area and COLA area price surveys. Correcting these deficiencies would insure that the COLAs more accurately reflect differences in prices. Additionally, State's COLA would be improved if sale prices were weighted to reflect the proportion of purchases made at sale and regular prices.

RECOMMENDATIONS

We recommend that the Secretary of State:

- Use a scientific sampling system to make living pattern surveys and direct field offices to use the results of living pattern surveys as a basis for selecting outlets for the price surveys.
- Revise the price collection schedule to minimize the timelag between base area and COLA area price surveys.
- Weight sale prices to reflect the proportion of purchases made at sale and regular prices.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our

recommendations. This written statement must be sent to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report. A written statement must also be sent to the House and Senate Committees on Appropriations with an agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget, and to the Chairmen, House and Senate Committees on Appropriations, Senate Committee on Governmental Affairs, and House Committee on Government Operations. Copies are also being sent to the Chairmen, Senate Committee on Foreign Relations and House Committees on Foreign Affairs and on Post Office and Civil Service.

Sincerely yours,


Clifford I. Gould
Director