Comptroller General of the United States

Washington, D.C. 20548

Decision

Matter of: Federal Mediation and Conciliation Service--Propriety of Financial Management Service Charges Under the Economy Act

File: B-257823

Date: January 22, 1998

DIGEST

The Federal Mediation and Conciliation Service (FMCS) claims that Financial Management Service (FMS) overestimated the amount of time FMS employees spend on administrative and other matters that FMS charges to all customers as an indirect cost for work performed pursuant to the Economy Act, 31 U.S.C. § 1535. As a result, according to FMCS, FMS charges all of its customers for employee time properly chargeable to, and payable by, identifiable customers. GAO's role is not to recompute FMS's standard hourly rate but to assess its general accuracy as a means to recover "actual costs" consistent with the dictates of the Economy Act.

FMS estimates the amount of time its employees spend on administrative and other matters not directly chargeable to any one of its customers using historical data on actual levels of work performed, administrative workload, and lead time between customers, as well as estimates of anticipated workload growth. Based on our review of FMS's methodology, we have no basis to conclude that FMS's estimate is inconsistent with the requirements of the Economy Act.

DECISION

The Director of Budget and Finance, Federal Mediation and Conciliation Service (FMCS), requested our opinion on the propriety of charges made by the Financial Management Service (FMS), Department of the Treasury, for technical assistance provided in fiscal years 1993 and 1994 under reimbursable agreements entered into pursuant to the Economy Act, 31 U.S.C. § 1535. The Economy Act requires agencies to recover the actual cost of goods and services provided. 31 U.S.C. § 1535(b). FMCS questions the methodology used by FMS to calculate its charges. FMCS asserts that FMS charges were in excess of actual cost because FMS charged FMCS (as indirect costs) costs that were properly chargeable to other FMS customers. For the reasons stated below, we do not object to FMS's methodology for calculating costs.

Background

FMS provides accounting services to agencies and organizations on a reimbursable basis. For this purpose, FMS established the Center for Applied Financial Management (Center). The Center is a separate unit within FMS with its own staff, equipment and space. Its sole purpose is to perform work and provide services to its customers.

FMS agreed to help FMCS develop an administrative accounting system and to provide implementation support under a memorandum of understanding (MOU) and three reimbursable agreements entered into in July and August, 1993. The MOU required FMCS to reimburse FMS for the actual costs of Center personnel assigned to the project, and other costs incurred in providing the services. FMS charged FMCS a total of $194,846 under the agreements. FMCS has questioned the methodology used by FMS to calculate its costs in performing under the MOU.

While FMS can track direct costs chargeable to any given project, it needs to allocate indirect costs, including overhead, attributable to a project. FMS uses standard hourly rates to capture, and bill, direct and indirect costs associated with personnel assigned to a project. FMS premised its methodology for establishing its standard hourly rates on the presumption that all of the Center's costs of operation are chargeable to the Center's customers. Since FMS established the Center as a separate and self-sufficient unit within FMS for this very reason, FMS charges all of the Center's costs of operation to customers either as direct or indirect costs.

To arrive at a standard hourly rate, FMS identifies all of its "billable employees" and categorizes each by grade. FMS calculates a standard hourly rate for each general schedule grade to reflect both direct and indirect costs. It defines direct costs, generally, as the salaries and benefits of its billable employees. Billable employees are those of its staff who work directly on projects and whose time is charged directly to projects, as opposed to management and support staff who do not charge their time to specific projects. FMS factors the cost of management and support staff, as well as overhead, into the standard hourly rate as indirect costs.

FMS recognizes that a portion of time spent by billable employees is not directly chargeable to any particular customer, and needs to be accounted for as an indirect cost. To compute these costs, FMS estimates that each billable employee will devote, on average, 1400 hours per year to directly working on projects. The Office of Management and Budget (OMB) has advised agencies that of the 2088 hours attributable on an annual basis to a federal employee, each employee works only 1744 hours per year. OMB Cir. No. A-76 (Revised), "Performance of Commercial Activities," p. IV-8 (Aug. 1983). The 1744 hours reflects the average amount of annual, sick, holiday, and administrative leave used. FMS estimates that for its billable employees, 344 of the 1744 hours are attributable to administrative and other matters that do not directly relate to specific projects. FMS considers these activities to be "nonbillable activities," and captures their cost to FMS (that is, the percentage of a billable employee's annual salary and benefits that correlates to 344 hours) in the standard hourly rates as an indirect cost.

During the course of any particular project, FMS tracks for each billable employee the actual number of hours that employee works on the project. FMS determines the amount to charge its customer for that particular project by adding together the products derived from multiplying the number of hours worked by each FMS employee on a particular project by the standard hourly rate for the employee's grade.

FMCS questions FMS's use of 1400 hours in computing the indirect costs attributable to billable employees. FMCS states, "It is our belief that the formula includes too many indirect costs and that the 1400 hour figure is too low." In conversations with us, FMCS elaborated that it believes any given billable employee probably devotes more than 1400 hours of his annual work schedule to direct work on projects. FMCS argues that as a consequence, FMS, in all likelihood, has included in indirect charges, allocated among all of FMS's customers, costs that, in actuality, are attributable directly to, and should be paid by, specific projects. FMCS has not supplied any data to support its belief.

Discussion

Resolution of the issue raised by FMCS requires an understanding of the Economy Act, 31 U.S.C. § 1535. The Economy Act authorizes agencies to enter into agreements, such as this MOU, for the interagency provision of goods and services. Id. The Act requires that the ordering agency, in this case FMCS, pay the performing agency, FMS, "the actual cost" incurred in providing the goods or services ordered. 31 U.S.C. § 1535(b). As used in the Economy Act, the term "actual cost" includes all direct costs attributable to providing the goods or services ordered, as well as indirect costs funded out of the performing agency's currently available appropriations that bear a significant relationship to providing the goods or services. 57 Comp. Gen. 674, 682-83 (1978).

Agencies possess some flexibility in applying the Act's "actual cost" standard to specific situations, so long as there is reasonable assurance that the performing agency is reimbursed for its costs without the ordering or the performing agency augmenting its appropriations. B-250377, Jan. 28, 1993. Thus, we have not objected to the use of a standard cost for items provided out of inventory (B-250377, Jan. 28, 1993), or to a standard level user cost for the use of storage space (B-211953, Dec. 7, 1984). From a fiscal law perspective, our concern is whether reimbursements are based on reasonable standard cost determinations that do not augment appropriations or otherwise run afoul of the Economy Act. Id.

The issue FMCS raises goes to the reasonableness of FMS's calculation of its standard hourly rate, in particular, the use of the 1400 billable hours per year estimate. Based on our review of FMS's methodology for establishing its standard hourly rates, including the estimate for billable hours per year, we have no basis to object to its standard hourly rates for billing a project's "actual cost" to an agency under the Economy Act.

Although FMS's accounting system can identify direct labor and other direct costs with each customer, a basis is necessary to allocate its other costs. Because of the multiplicity of customers and FMS employees serving any one customer and because of the complexity in tracking and allocating the myriad indirect costs to individual customers, FMS decided, not unreasonably, to use standard hourly rates by grade to support its recovery of all costs incurred in providing services to customers. See B-230377, Jan. 28, 1993 (ability of performing agency's accounting system to identify all actual costs relevant factor in determining reasonableness of agency's use of standard costs).

To establish its standard hourly rate, FMS gathers the historical cost of the Center for both personnel and nonpersonnel costs, considers in detail each employee's personnel costs including promotion and step increase projections, and factors in estimated cost of living increases, rent increases, etc. Before calculating the standard hourly rate, FMS deducts costs such as travel costs that are billed directly to the customer agency and estimates billable hours per employee for the year. To make this estimate, FMS uses a two-step process. It starts with guidance contained in OMB Circular A-76 indicating that the average federal worker, after eliminating annual, sick, holiday, and administrative leave, works an average of 1744 hours per year. OMB Cir. No. A-76, at IV-8. Next, FMS considers historical data on actual levels of hours worked directly on a project, administrative workload and lead time between customers, and anticipated growth estimates to determine the percentage of average hours worked per year that an employee is able to bill for actual hours worked. For the period in question, FMS established this percentage at approximately 80%, or 1400 hours. To calculate the standard hourly rates, FMS groups all estimated billable hours by employee into their respective grades, indexes the grades to the Office of Personnel Management (OPM) pay schedule to keep the final rates per grade aligned with the OPM pay schedule, and then produces standard hourly rates per grade that recoup the Center's costs.

FMCS expresses particular concern with FMS's estimate that out of 1744 hours the average employee actually works per year, FMS's billable employees spend 344 hours on administrative and other matters that are not directly chargeable to any particular project. FMS considers the cost of the 344 hours to be indirect costs that are spread out among all of FMS's customers. FMCS suggests that the average billable employee probably spends more that 1400 hours per year working on tasks that are directly chargeable to identifiable customers. If that is the case, FMCS argues, all customers are paying for a portion of the billable employee's time that should properly be paid by the customer on whose project that employee was working.

Although we appreciate the significance of FMCS's argument, our review of the record before us does not support the essential premise of FMCS's concern, namely, that FMS's estimate of the number of billable hours worked per year by a Center employee is unreasonably low. Certainly FMCS does not, nor could it, disagree with the proposition that Center employees will spend some portion of their productive time working on administrative and other matters either because of the need to address these matters or because of lead time between customers. Similarly, a portion of the Center's employees' time will be spent each year on training and other professional activities. If this much is conceded, as we think it must be, the issue is one of degree. It is not our role to recreate FMS' computation of billable hours but to assess its general accuracy as a means to recover "actual costs" consistent with the dictates of the Economy Act. The test is whether the computation of standard cost produces a reasonable approximation of actual costs, not exacting precision. B-250377, Jan. 28, 1993.

FMS has obvious incentives to minimize indirect costs. Because of the nature of the service FMS's Center for Applied Financial Management provides, i.e., technical assistance in designing and implementing accounting systems, FMS, in fact, competes with other, nonfederal, providers. To the extent that FMS can maintain low overhead and other indirect costs, FMS enhances the competitiveness of its charges to its customers. Further, as noted in our description of FMS's methodology, FMS used historical data on actual levels of work performed, administrative workload, and lead time between customers plus estimates of anticipated growth in Center workloads to arrive at the percentage of an employee's hours billed directly to a customer's project. We have no basis to object, either in concept or application, to the methodology used by FMS to estimate the amount of hours that its employees will directly bill customers per year.

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