

Office of Inspector General

Review of FMC's User Fee Calculations

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FEDERAL MARITIME COMMISSION



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800 North Capitol Street, N.W.
Washington, DC 20573

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Office of Inspector General

TO: Ronald D. Murphy
Managing Director

FROM: /Adam R. Trzeciak/
Inspector General

SUBJECT: User Fee Calculations

The Office of Inspector General (OIG) initiated a review of various aspects of the Federal Maritime Commission's (FMC) process to establish user fees for agency activities that convey special benefits to recipients beyond those accruing to the general public. Guidance for establishing such fees is contained in Office of Management and Budget (OMB) Circular A-25, *User Charges*.

The Circular requires user charges to be sufficient to recover the government's full cost. Full cost includes all direct and indirect costs to any part of the federal government of providing a good or service. These costs include, but are not limited to, an appropriate share of: (i) direct and indirect personnel costs, including salaries and fringe benefits, such as medical insurance and retirement; and (ii) physical overhead, consulting and other indirect costs including material and supply costs, utilities, insurance, travel and rents or imputed rents on land, buildings or equipment.

The OIG began this review in January 2008. During the initial weeks of the audit, the OIG determined that the agency followed a process that incorrectly set its user fees for various mission-related services, resulting in user fees that understated the agency's costs to provide these services. The OIG reported the finding to management who then took steps to reexamine its calculations in light of our findings. We suspended further audit steps until the agency amended its fee-setting calculations.

The OIG recognizes that capturing all costs associated with providing services would substantially increase fees charged to the public. For example, using OIG calculations, the agency would assess \$222 of overhead for every \$100 of labor. By comparison, the

agency is currently allocating \$92 in overhead for every \$100 of labor charged. If the agency determines that collecting full costs are inconsistent with policy goals or mission objectives (e.g., dramatically increasing licensing fees may reduce compliance rates), then the agency should consider alternatives to setting its fees to capture costs and seek concurrence from the Office of Management and Budget.

The OIG is recommending that the agency either (i) establish user charges that reflect the full cost of the activity provided, as directed in Generally Accepted Accounting Principles and Cost Accounting Standards, or (ii) with the approval of the Office of Management and Budget, set fees below the full cost if the agency determines that recouping full costs would be a financial burden on the industry or the public.

Discussion of Findings

The OIG analyzed the methodology behind the fees charged to the public for services. The OIG concluded that the fees are set too low to recover full costs of providing the service to the public.

To impose a user fee on a private party receiving a benefit, the agency must show that: (i) it has identified the specific agency activity or activities for which the fee is being assessed; (ii) the value of that service is reasonably related to the fee; and (iii) the benefit accrues, at least in part, to an identifiable private beneficiary and not merely to the industry as a whole.

In 2007, Office of Administration (OA) staff chaired the user fee working group, consisting of representatives from several agency offices and bureaus with fee-generating responsibilities. The working group began meeting in March 2007 to update cost factors that supported the agency's user fees.¹ The cost factors were then provided to the Office of Financial Management (OFM) to establish an overhead worksheet from which the new user fees would be calculated. In January 2008, the working group presented its findings to the Commission before preparing a draft notice of proposed rulemaking to enable the public to comment on the proposed fees.

The OIG reviewed OMB Circular A-25, *User Charges*, dated July 8, 2003, as it relates to the establishment of user fees and OMB Memorandum M-07-02, *Update to Civilian Position Full Fringe Benefit Cost Factor, Federal Pay Raise Assumptions, Inflation Factors, and Tax Rates used in OMB Circular A-76, "Performance of Commercial Activities,"* dated October 31, 2006, which requires agencies to use standard cost factors to estimate certain costs of government performance. We also reviewed user fee work sheets prepared by staff from fee-generating bureaus and offices and staff's calculation of indirect (i.e., overhead) costs.

The user fees established are based on direct labor costs plus fringe benefits, multiplied by a calculated overhead rate. The OIG did not review staff's labor-hour estimates for each fee-generating activity to determine whether the estimates were reasonable. We did, however, examine the assumptions behind the agency's overhead rate calculations. We found that the

¹ OMB Circular A-25 also calls for a periodic reassessment of costs, with related adjustment of fees, if necessary, and the establishment of new fees where none exist.

agency did not calculate and apply overhead rates in keeping with cost accounting principles.² For example, OFM failed to include all costs in its overhead rate calculations, (e.g., rent and utilities) and other support offices (Administrative Law Judges, Office of Equal Employment Opportunity and the OIG).

The cost data provided in this analysis is from FY 2006, which was the most recent available cost information when we performed our analysis. The agency has undergone a recent reorganization, resulting in some offices being merged and/or renamed with new responsibilities. However, the methodology employed would be identical under any organization, and the ultimate distribution between charges for direct labor and overhead would not vary by much. The OIG is able to advise management on a proper cost accounting system and is willing to assist management to update the cost calculations upon management's request.

The results of our analysis of the most recent cost calculations prepared by staff in the agency's Office of Budget and Finance (formally OFM) is presented below by cost category.

Miscalculation of the Fringe Benefit Overhead Rate

Our review of the overhead worksheet prepared by OFM identified a "fringe rate" of 55.12 percent. This rate incorrectly included leave and holiday costs in the "fringe" calculation. By including them, the agency was double counting because leave and holiday costs are already included in the base hourly pay rate for federal employees. OFM used guidance from the Defense Logistics Agency in developing its "fringe rate." While the guidance refers to OMB Circular A-76, *Commercial Activities*, the FMC should have used the "fringe rate" provided in the circular itself. According to OMB Circular A-76, the full fringe benefit cost factor is comprised of four separate elements: (i) insurance and health benefits, (ii) standard civilian retirement benefits, (iii) Medicare benefits, and (iv) miscellaneous fringe benefits. OMB determined, based on information provided by the Office of Personnel Management, that the civilian position full benefit cost factor is 36.45 percent, as of October 31, 2006. This rate is almost 19 percent less than the rate used by the FMC.

Internal Overhead Rate Overstated

When identifying the overhead costs for five bureaus and offices with fee-generating responsibilities, OFM calculated an "internal" overhead rate, which represented non-labor related costs, such as travel, training and supplies, within the respective cost centers, of 8.08 percent. We noted that the OFM calculation did not include rent and select other expenses in its calculation. The OIG calculated these costs separately, as discussed below. Excluding rent for comparison, our calculated internal overhead rate was 6.54 percent.

² Office of Financial Management's direct and indirect cost calculation worksheet is attached at Appendix A. The OIG used this worksheet as the basis of our analysis. OIG analysis is presented in Appendix B.

Commission General and Administrative Rate Understated

The OFM calculated the Commission's General and Administrative (G&A) rate by including salary and benefit costs for the Offices of the Chairman, Commissioners, General Counsel, Administration and Operations. Several other Commission offices, to include the Office of Equal Employment Opportunity, the Library, Office of Inspector General and the Office of Administrative Law Judges, were erroneously excluded in the FMC's indirect or "support costs."

Notwithstanding the omission of many support functions, OFM incorrectly applied the formula for calculating overhead. For example, it divided the salary and benefit costs accumulated for the five offices into the total costs of the FMC to arrive at overhead. This calculation is incorrect for two reasons.

First, OFM should have removed these "support costs" from the total agency costs before calculating this overhead rate. For example, the agency determined that the salary and benefit costs of the Chairman's office, Commissioner offices, etc., was \$5.8 million. It then divided this sum by total agency expenses for the year (\$20.3 million). This resulted in an OA calculated overhead rate of 28.78 percent.³ Using the agency's cost data and assumptions, the correct calculation would be to first subtract the "support" costs from the total costs (\$20.3m - \$5.8m = \$14.5m), then divide \$14.5 into the \$5.8m. This one modification would increase the overhead rate attributed to support offices to 40 percent.

But this overhead rate (40 percent) is still understated because it does not include rent and similar costs for these five "support" offices. In its financial reports, FMC has a cost center titled "Overhead." In the OFM calculations, these costs were part of the agency's total costs (\$20,294,010), but the costs were not allocated out to agency bureaus and offices as overhead. Consequently, we could not determine what portion of the agency's rent was allocated to any direct programs or support offices. To include these costs in the overhead rate, the OIG allocated them to all Commission offices based on square footage. This increased Commission G&A costs (i.e., those "support offices") by \$1,389,917. Adding this to the Commission G&A costs, and dividing it into all other costs of the FMC,⁴ provided an overhead rate for Commission G&A of 70.72 percent, versus an OFM-calculated rate of 28.78 percent.

It should be noted that OFM considered all the costs in offices of the Chairman, Commissioners, General Counsel, Administration and Operations to be overhead. A study of these costs may reveal that some of them are program or direct costs, and not overhead. Removing those costs would lower the overhead rate.

Allocating Rent and Other Overhead

As noted above, OFM did not consider rent and similar costs when it identified administrative costs for fee-generating (direct program) offices. It therefore understated total costs for these offices; in effect, calculating rent overhead to be \$0. The OIG allocated rent and similar costs to

³ \$5.8m / \$20.3m = 28.78 percent

⁴ Total Cost of Support Offices / Total Agency costs less support costs = \$8.4m / \$11.9m = 70.72 percent

the cost centers of the fee-generating offices. These costs equated to 30.05 percent of the costs built up for “fee-generating” offices’ labor and internal overhead. This 30.05 percent would, in effect, apply to all programs and costs other than “Commission G&A.”

Computing the Overhead Rate

Another observation we made that results in understating overhead is that OFM added its calculated rates together, rather than applying them, as illustrated below:

	<u>OIG</u>	<u>OFM</u>
• Fringe rate	36.45%	55.12%
• Internal Overhead for five fee-generating offices	6.54%	8.08%
• Overhead to direct programs for rent and misc., costs	30.05%	0%
• Commission G&A, including rent and misc., costs added to five overhead cost centers	70.72%	28.78%
TOTAL	***	<hr style="width: 100%; border: 0.5px solid black;"/> 91.98%

*** Because the rates are multiplied, and not added, the rate is **222.75 percent**. See the mathematical proof below:

Proof:

Direct Program Costs, including fringe and internal costs		\$9,140,406
Direct Program overhead costs for rent and similar administrative expenses	x 30.05%	<hr style="width: 100%; border: 0.5px solid black;"/> 2,746,740
Subtotal		11,887,146
Non-Direct Program Costs, including rent and similar administrative expenses	x 70.72%	<hr style="width: 100%; border: 0.5px solid black;"/> 8,406,864
FMC TOTAL COSTS		<hr style="width: 100%; border: 0.5px solid black;"/> \$20,294,010

For every \$100 of labor for each fee-generating activity, the agency should add \$222.75 of overhead to arrive at \$322.75 totaled burdened costs. This equates to an overhead rate of 222.75 percent. This can be seen mathematically as follows:

Direct labor services		\$100.00
Fringe costs	36.45%	<u>36.45</u>
Subtotal		136.45
Internal Overhead/Programs	6.54%	<u>8.92</u>
Sub-total		145.37
Overhead for Direct Labor	30.05%	<u>43.68</u>
Sub-total		189.05
FMC overhead cost of Commission G&A	70.72%	<u>133.70</u>
Subtotal		322.75
TOTAL DIRECT LABOR PLUS OVERHEAD		\$322.75

Recommendation

The OIG recommends that the Office of the Managing Director either (i) establish user charges that reflect the full cost of the activity provided, or (ii) with the approval of the Office of Management and Budget, set fees below the full cost if the agency determines that recouping full costs would be a financial burden on the industry or the public.

Agency Response

Management's comments are attached to the report in their entirety.

Attachments

APPENDIX A

MANAGEMENT DIRECT AND INDIRECT COST CALCULATION WORKSHEET

INDIRECT COST CALCULATIONS
(Applied to Direct Cost)

A. Government Overhead Costs -

Fringe benefits and other wage-related government contributions from OMB Circular A-76:

Leave and Holiday	22.67%
Retirement	23.70%
Workmen's Comp. Awards	1.70%
Health, Life Insurance	5.60%
Medicare	1.45%

Total	55.12%

B. Commission General and Administrative -

Expenses allocated to the office of the Commissioners, General Counsel, and Bureau of Administration (FY 2006 amounts from 2006 Final Report)

FMC9110000 Chairman	191,517
FMC9111000 Commissioner	1,140,561
FMC9130000 General Counsel	1,505,504
FMC9910000 Office of Administration	2,489,439
FMC9810000 Office of the Operations (Director)	513,953

Total	5,840,974

Calculation of overhead percentage:

- Commission G & A / Agency Funding = % Overhead	
- Total Agency Funding for FY 2006	20,294,010
- Commission G & A	5,840,974
- Overhead Percentage:	28.78%

C. Commissions General and Administrative

Overhead expenses allocated to Office & Bureaus involved in fee-generating activities.

FMC9120000 Secretary	51,391
FMC9500000 Bureau of Trade Analysis	72,750
FMC9600000 Bureau of Certification & Licensing	52,464
FMC9710000 Bureau of Enforcement	40,797
FMC9800000 Office of Operations (ARs)	25,821

Total	243,223

Calculation of overhead percentage:

- Overhead Expense / Bureau/Office Funding = % Overhead	
- Funding for Bureaus/Office: (FY 2006 amounts from FY 2006 Final Report)	
FMC9120000 Secretary	602,374
FMC9510000 Bureau of Trade Analysis	1,012,038
FMC9600000 Bureau of Certification & Licensing	614,949
FMC9710000 Bureau of Enforcement	478,204
FMC9800000 Office of Operations (ARs)	302,470

Total	3,010,035
- Office G & A	243,223
- Overhead Percentage:	8.08%

D. Total Indirect cost Factor (Sum of A through C)

A. Government Overhead Cost	55.12%
B. Commission General & Administrative	28.78%
C. Office General & Administrative	8.08%

Total	91.98%

APPENDIX B

**OIG COMPUTATION OF OVERHEAD USING
FY 2006 EXPENSES**

Office of Inspector General
Direct Program and Overhead Cost Calculations

Chairman	391,568	3.84
Commissioners	1,147,926	8.43
Secretary	708,486	
CADRS	776,720	
Library	253,049	
General Counsel	1,574,369	5.01
ALJ	181,916	
EEO	158,658	1.15
OIG	461,868	1.49
BTA	2,463,748	
BCL	1,776,766	
BOE	1,381,899	
Operations	709,302	
Area Reps	874,820	
Admin	608,057	1.91
OIT	1,330,982	3.72
OHR	389,924	2.53
OFM	420,556	2.33
OMS	533,049	3.19
Plug	13,700	
Overhead	4,136,657	
TOTALS	20,294,020	33.6

		Direct Program Labor & O/H		
	391,568			
	1,147,926			
		708,486	656,967	51,519
		776,720		
		253,049		
	1,574,369			
		181,916		
	158,658			
	461,868			
		2,463,748	2,294,472	169,276
		1,776,766	1,739,774	36,992
		1,381,899	1,317,188	64,711
		709,302	599,804	109,498
		874,820		
	608,057			
	1,330,982			
	389,924			
	420,556			
	533,049			
		13,700		
	1,389,917	2,746,740		
	8,406,874	11,887,146	6,608,205	431,996
				7,040,201

G/A O/H Rate

70.72%

O/H alloc. to Programs

2,746,740

Programs less O/H alloc.

9,140,406

O/H for Programs (rent, etc.)

30.05%

O/H within Programs (travel, training, supplies)

6.54%

Office of Inspector General
Direct Program and Overhead Cost Calculations

Direct Labor	\$ 100.00
Fringe Rate	36.45%
Fringe Cost	\$ 36.45
Direct Labor & Fringe	\$ 136.45
Programs Internal O/H Rate	6.54%
Program Internal O/H Cost	\$ 8.92
Program labor, fringe and internal O/H	\$ 145.37
Rent etc., alloc to programs - rate	30.05%
Rent etc., alloc to programs - cost	\$ 43.68
Programs labor, fringe, internal O/H, and Rent etc., O/H	\$ 189.05
Support O/H rate on labor, fringe, rent, internal	70.72%
O/H cost on support program labor, fringe, etc.	\$ 133.70
Total Cost of \$100 direct program labor	\$ 322.76
Rate on \$1 of Direct Program Labor	222.76%

Memorandum

TO : Inspector General

DATE: May 25, 2010

FROM : Managing Director

SUBJECT : User Fee Report

This responds to the report of user fee calculations dated March 25, 2010. I believe that a re-evaluation of existing user fees should be made. I also recognize there may have been some uncertainty and concerns about previous methodology. Accordingly, I have initiated a project to determine the full cost of services for which the Commission assesses user fees. Total costs will be calculated in accordance with the requirements of OMB Circular A-25 and applicable Federal Financial Accounting Standards. Once those costs are determined, a proposed rule will be recommended to the Commission, with the goal of issuing a final rule by December 31, 2010.

/Ronald D. Murphy/

Cc: Director, Office of Budget and Finance