

GAO

Report to the Chairman, Joint Committee
on Printing, Congress of the United States

August 1988

U.S. GOVERNMENT
PRINTING OFFICE

Materials Management
Service's Charges for
Handling Paper and
Materials



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

General Government Division

B-205592

August 8, 1988

The Honorable Frank Annunzio
Chairman, Joint Committee on Printing
Congress of the United States

Dear Mr. Chairman:

The previous Chairman requested that we examine the operations of the Materials Management Service (MMS) of the Government Printing Office (GPO), which procures and distributes printing supplies and services to GPO printing operations and other government agencies. He asked whether handling charges that MMS assesses its customers were proper from the standpoint of generally accepted accounting principles and equitable according to the level of services provided. He also asked whether MMS cost centers are sufficient to properly determine and allocate costs. Finally, he asked that we recommend ways to reduce MMS operating expenses, which the handling charges are intended to recover in full.

Results in Brief

MMS operating costs are accumulated at MMS cost centers, and MMS customers are charged handling charges to recover those costs. The number of MMS cost centers was sufficient to properly determine and allocate costs. Direct costs such as salaries were properly and accurately assigned to the centers. However, some allocated costs were not properly and accurately assigned to the centers or were distributed to the centers on the basis of incorrect data.

MMS had two handling charges, a 35-percent charge to all customers who bought certain items such as paper and envelopes from MMS' inventory and a 6-percent charge to all customers who bought the items for direct shipment from vendors. Customers buying something other than these items paid no handling charge, even though MMS incurred costs. No specific data were found to support the size of the two charges that were assessed.

Background

MMS, in the Office of the Assistant Public Printer for Procurement, is responsible for the acquisition and management of materials, supplies, equipment, and services for GPO. Its primary role is to support GPO production facilities, but it also sells paper and related supplies to government activities outside GPO. MMS provides receiving, shipping, and

storage services and maintains inventories of paper, envelopes, materials, and supplies for issuance to GPO production operations and to fill government agency requests. The procurement staff, which numbered 36 in January 1988, also places orders on behalf of government agencies for direct shipment from vendors' plants to the agencies. During fiscal year 1987 MMS' procurements totaled \$90.3 million.

Two elements of the GPO accounting system are (1) cost centers, where revenue and direct and allocated expenses are accumulated; and (2) Cost Recovery Areas, where cost centers are brought together to show the results of operations. MMS is one such Cost Recovery Area.

As a Cost Recovery Area, MMS includes 10 cost centers corresponding to MMS organizational units; for example, Cost Center 1015, Office of the Director, MMS; Cost Center 1025, General Procurement. Two additional cost centers outside MMS are also included in MMS' Cost Recovery Area: (1) the costs of quality control services provided to MMS by the Quality Control and Technical Department, and (2) the costs of GPO's Paper and Materials Control Section in the Office of Customer Services. MMS' revenue is generated primarily from the addition of handling charges (1) to the purchase price of paper and materials issued from inventory and (2) for processing direct vendor shipments to government agencies.

MMS sells primarily to internal GPO production operations and, on occasion, to other government agencies. A 35 percent handling charge, calculated on GPO's average item cost, is included in the GPO catalog prices for items in MMS inventory. Similarly, a 6 percent handling charge is added to each purchase order for paper and materials GPO places with commercial vendors for direct shipment to government agencies.

MMS handling charges are monitored by the GPO Comptroller's office. If it appears from detailed monthly financial statements that the MMS Cost Recovery Area is likely to have a surplus or deficit at the end of the fiscal year, the Comptroller's office may recommend a change. In August 1986 the handling charges of 30 percent and 5 percent were raised to 35 percent and 6 percent.

Objectives, Scope, and Methodology

The Committee requested that in doing our work we place particular emphasis on the development and implementation of the handling charges. It requested that the review specifically include

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- an analysis of the propriety of the handling charges from the standpoint of generally accepted accounting principles;
 - a determination of whether the existing handling charges are equitable according to the level of service provided, so that no customer is charged an inappropriate share;
 - a determination of whether the cost centers established by MMS are sufficient to properly determine and allocate costs; and
 - recommendations on ways in which the operating expenses of MMS might be reduced.

The Committee agreed that in analyzing the propriety of the handling charges, our objective should be to determine whether MMS is charged a disproportionate and unfair amount of the general overhead charges of operating GPO.

To answer the Committee's overall request, we examined the development and imposition of handling charges assessed by MMS on issues of paper and materials to GPO production activities and to other government agencies.

We researched available accounting literature on generally accepted accounting principles and their application to MMS cost assignments. On the basis of this research, we concluded that generally accepted accounting principles are not applicable to determinations of internal cost allocations.

We used concepts issued by the Cost Accounting Standards Board to evaluate the appropriateness of the costs assigned to MMS cost centers. Specifically, we used the concept of causality as the primary criterion to evaluate the appropriateness of the costs assigned to MMS cost centers through direct assignment and allocation of indirect costs. As applied here, this concept states that costs shall only be attributed to cost objectives—in this case, MMS cost centers—when a causal relationship exists between costs and cost objectives.¹ It has been pointed out, however, that causality as a cost allocation concept may be less than all-encompassing. For example, it may be difficult to associate fixed central

¹Issuances of the Cost Accounting Standards Board are incorporated by reference as executive agency guidance in Title 2, GAO Policy and Procedures Manual for Guidance of Federal Agencies. Title 2 standards have been used as criteria for several earlier reports on GPO operations. For a more detailed discussion of causality stated as a principle, see Railroad Accounting Principles: Final Report, Volume 2, Chapter 1, Railroad Accounting Principles Board, September 1, 1987.

administrative costs with the causality concept. In such a case, a "beneficial" relationship could be used as a surrogate for the causal relationship.² For our review we used both, applying each as appropriate.

We judgmentally selected direct and allocated costs in MMS cost centers for detailed review. In selecting items for review we considered the largest (in dollars) and most active (number of transactions) accounts. We selected a variety of direct and allocated transactions in fiscal year 1986. We selected transactions that would give us a cross section of the different charges included in major direct and allocated accounts. However, because these transactions were not randomly selected we cannot project the results of our review to all MMS transactions during the period we reviewed. In March 1988 we confirmed with GPO's Comptroller that accounting for MMS costs had not changed since we did our work.

We reviewed the dollar amounts of charges and how they were related to MMS cost centers. We reviewed the validity of selected transactions by examining all supporting documentation and accounting actions.

We interviewed Office of Comptroller officials and MMS management to understand the nature of the handling charges and how they are determined and applied. We also interviewed responsible officials in the MMS procurement and stores functions. We also met with quality control and customer services staff.

To find ways to reduce MMS operating expenses we considered the applicability of improved automation practices of other users of paper products and printing materials such as commercial printers. We also reviewed MMS depot utilization, storage and issue procedures, and material handling methods. We visited MMS storage facilities in Springfield, Virginia, and in Washington, D.C., including storage facilities in the main GPO building. We also visited the offices of The Washington Post newspaper in Washington, D.C., and R.R. Donnelly, a major commercial printer

²For a discussion of the "causal" and "beneficial" relationships in cost allocations, see Gordon Shillinglaw, "Cost Accounting Principles For External Reporting" in Essays in Honor of William A. Patton, University of Michigan, 1979, pp. 157 to 183.

of magazines and catalogs with facilities located in Lancaster, Pennsylvania. We did not find significant ways to reduce MMS costs.³

We did our work in accordance with generally accepted government auditing standards. GPO provided comments on this report, which are presented on pages 9 and 10.

Equity of Handling Charges

Costs for MMS cost centers include (1) direct costs; and (2) allocated costs, which are distributed monthly to all GPO cost centers, including those in MMS, on bases approved by the GPO Comptroller's office.

Direct Charges to MMS Cost Centers Were Proper

Direct expenses are costs assigned directly to MMS cost centers, for example: personnel services and benefits; travel and transportation of persons and things; rent, communications, and utilities; printing and reproduction; supplies and materials; depreciation; and others. We traced 58 transactions in 16 accounts that had been recorded in MMS cost centers during 1986. The costs were traced to the supporting documentation and accounting records.

We found that the costs were accurately assigned to MMS cost centers, and MMS cost centers were not charged for costs that should have been assigned to other cost centers. The costs were in the proper amounts and were supported by appropriate documentation. They were costs causally related to the MMS cost objectives.

Some Allocated Charges to MMS Cost Centers Were Questionable

GPO's allocated costs are accumulated and periodically distributed to cost centers on a predetermined basis. We reviewed the bases of allocations used by GPO in the five major allocated accounts where charges were made to MMS cost centers: Engineering Service Charges, Other Internal Charges, Transfers, Administrative Services, and Buildings Expense.

³Previous GAO reports on GPO operations have suggested ways in which economy and efficiency could be improved. A 1982 report, *GPO Needs to Analyze Alternatives to Overcome Physical Limitations in Government Printing Operations* (PLRD-82-20, Jan. 4, 1982) stated that many inefficiencies in GPO's manufacturing operations are related to the GPO facilities. These facilities create problems in material handling, space limitations, and constraints on the arrangement of equipment on the production floor. Alleviating these problems would entail redesigning the existing facilities, expanding them, or constructing new facilities.

In general, the costs allocated to MMS cost centers appeared to be causally or beneficially related to activities of MMS cost centers and were reasonable compared to costs allocated to other GPO cost centers. However, we questioned the distribution used in two of the allocated accounts.

In the Engineering Service Charges account we found all charges for applying property numbers to property throughout GPO for property management accounting were allocated to one MMS cost center: Center 1015, Office of the Director. MMS' part of these expenses should be proportionate to MMS' share of GPO property. Because we do not know what share of GPO's property MMS holds, we cannot say what proportion of the costs should have been charged to MMS. Fiscal year 1986 charges totaled \$44,400.

In the Buildings Expense account, space costs are allocated to occupying activities as industrial, office, or storage space. Each category of space is charged at a different rate. Using a weighted system, industrial space is charged at 100 percent, office space at 46 percent of the industrial rate, and storage space at 38 percent of the industrial rate. We reviewed the basis for the rates used to allocate space and found that the rates had not been reviewed or changed since March 1965. GPO officials could not provide documentation to establish the current validity of these rates.

We also found that several MMS cost centers were being charged for more space and different kinds of space than they occupied. For example, some procurement office space that should have been weighted as office space and charged at 46 percent of the industrial rate was classed and charged at the 100 percent industrial rate.

In all, we found that MMS cost centers were being overcharged for about 3,942 weighted square feet of space. Revised space charges using the corrected space allocations and correct classifications would have reduced the charges to MMS cost centers about \$10,200 per month in fiscal year 1986, or about \$122,000.

Specific Data Were Not Available to Support the Size of the Handling Charges

MMS handling charges are levied without exception on all customers buying paper and materials through MMS. The 35-percent charge is added to the cost of paper, envelopes, materials, and supplies from inventory; the 6-percent charge is added to the cost of direct shipments from outside vendors to government agencies.

GPO accounting officials said that the two handling charges are intended to reflect their respective shares of the cost of MMS operations. However, they could not provide specific data either from the cost accounting system or from any detailed study of the two handling charges to support the 35-percent and 6-percent rates.

Some Services Were Provided Without Applying Any Handling Charge

We also found that while the 35 percent handling charge is added to purchases from MMS' inventory and the 6 percent handling charge to direct shipments, many procurement actions done by MMS' procurement staff for other GPO cost centers are not subject to any handling charge. Examples of these actions include purchases of machinery and equipment costing more than \$3,000, building improvements, and service contracts.

We used the number of procurement transactions to estimate how much staff time was spent on procurements not subject to the handling charges. We believe this is a conservative approach, because GPO's Comptroller and MMS management agreed that procurements not subject to the handling charges are, on average, more complex and time-consuming than those subject to the charges. (MMS does not have a system to record the amount of time procurement staff devote to each procurement.)

About 14 percent of MMS procurement actions in fiscal year 1987 was for goods and services contracts not subject to any handling charge. Applying this percentage to the \$2.1 million annual operating cost of the two MMS cost centers that do procurement work, we found that about \$292,473 was attributable to procurements not subject to any handling charge. Users of the inventory system and purchasers ordering for direct shipment from vendors bear these costs through the two handling charges.

The way MMS handling charges are applied results in some users of MMS procurement services not paying their share of MMS' costs. Costs incurred should be associated with the benefits received, and activities receiving benefits should pay for them. These costs should be recovered through a separate handling charge applied to this third category of users of MMS procurement services.

Before we started work on this request, GPO had initiated a study of how MMS handling charges are administered. The ongoing study includes

alternatives for changing the accounting for MMS costs and possibly broadening handling charge coverage to include all procurements.

Adequacy of MMS Cost Centers

Government Printing Office Instruction 435.21 lists 243 cost centers used to account for the costs of GPO operations. Personnel time charges are accumulated by cost center through the GPO automated personnel and payroll system. Costs are directly accumulated by cost centers or are allocated to them as part of the overhead distribution process.

Each of MMS' 10 organizational components is a cost center. In addition to the MMS cost centers, two additional cost centers are included in MMS operations, and their costs are included in MMS financial statements. These two centers are (1) quality control services provided to MMS by the Quality Control and Technical Department, and (2) the Paper and Material Control Section in the Production Planning Division. The Quality Control and Technical Department tests the paper and materials procured by MMS procurement offices and manufactures inks that become part of the MMS inventory. The Paper and Material Control Section is the GPO liaison office for contacts with other government agencies. It receives procurement requests from federal agencies that are placed by MMS with the appropriate commercial vendor or filled from MMS inventory.

On the basis of our review of the number and structure of MMS cost centers, we believe the centers assigned to MMS are sufficient for accumulating all costs related to each MMS cost center and properly accounting for the activities involved. We do not see a need to change or expand the MMS cost center structure unless GPO finds this is necessary to improve the methodology for determining the appropriate size of handling charges.

Conclusions

We believe the MMS cost centers are adequate to record and accumulate MMS costs. On the basis of our examination of selected direct costs in MMS cost centers, we also believe that direct charges made to MMS cost centers were proper.

We found problems, however, with how costs were distributed in two allocated accounts to MMS cost centers. All the charges for applying GPO property numbers in the Engineering Service Charges account were allocated to MMS. Total costs in this account should be allocated to all GPO activities on a proportionate basis, and MMS should receive only its

share. The square footage assignments for allocating the Buildings Expense account were not based on actual MMS occupancy and square footage weights. Also, the rates for allocating building space as industrial, office, and storage were last revised in March 1965. On the basis of these findings, GPO should review periodically the basis of all cost allocations that affect MMS. Although the individual amounts may not be material, the fact that we found problems in two of the five allocated accounts we reviewed—problems that resulted in overcharges to MMS—indicates a need for GPO to make such a review.

Costs recovered in the two categories of MMS handling charges are applied equally to all customers in each category: those buying paper and materials through MMS' inventory all pay 35 percent, and those buying paper and materials for direct shipment from vendors all pay 6 percent. However, because GPO could not provide specific data to support the two rates, it needs to evaluate the validity of the present handling charges and develop a procedure to do this on a periodic basis.

Some procurement actions by the MMS procurement staff are for other GPO cost centers and are not subject to either of the two existing handling charges. MMS services to others for such actions as machinery and equipment purchases totaling over \$3,000, building improvements, and service contracts should also be subject to handling charges.

Recommendations

We recommend that the Public Printer direct the Office of the Comptroller to take the following actions:

- Review all allocation bases used to distribute costs to MMS cost centers. During this review the basis for allocating costs in the Engineering Services and the Buildings Expense accounts should receive special attention.
- Evaluate the validity of the present handling charges for issues from inventory and direct shipments of paper and materials from vendors, make any necessary adjustments, and make such evaluations on a periodic basis.
- Develop handling charges applicable to recovery of costs of MMS services provided to users of procurement services not now subject to a handling charge.

Agency Comments

We obtained official comments orally from GPO on a draft of this report. GPO fully concurred with our observations and plans to implement the

recommendations. GPO said the 35 percent handling charge has been reduced to 30 percent, effective April 1, 1988, for materials and supplies and May 1, 1988, for paper. However, it decided not to change the 6 percent direct shipment charge after reviewing it.

We are sending copies of this report to the Public Printer and will make copies available to others upon request.

Sincerely yours,



Richard L. Fogel
Assistant Comptroller General

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