United States General Accounting Office

GAO

Report to the Subcommittee on Treasury and General Government
Committee on Appropriations
U. S. Senate

July 1999

GENERAL SERVICES ADMINISTRATION

Information on Pricing Retail Packaging Products

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

General Government Division

B-281901

July 7, 1999

The Honorable Ben Nighthorse Campbell
Chairman

The Honorable Byron L. Dorgan
Ranking Minority Member
Subcommittee on Treasury and General Government
Committee on Appropriations
United States Senate

This report responds to Senate Report 105-251 on the fiscal year 1999 Treasury and General Government Appropriations Act, which directs us to examine the General Services Administration's (GSA) retail packaging products program. Retail packaging products include items such as boxes, envelopes, and shipping sacks. GSA sells 27 of these products to federal agencies, with the Postal Service being its largest customer. As agreed with the Committee, our objectives were to determine whether (1) GSA is required by law to set its prices for retail packaging products at levels sufficient to ensure that all selling costs are recovered on each item and (2) GSA's selling prices for these items do recover all costs.

Results in Brief

GSA is not required to, nor does it set prices to, recover all estimated costs associated with selling retail packaging products on an item-by-item basis. The statutory provision related to product pricing and cost recovery, 40 U.S.C. 756, specifically identifies the purchase price, transportation, and the direct and indirect costs associated with contracting, handling, and distributing products as the costs that GSA should recover, so far as practicable, through its selling prices. However, the law does not require GSA to use a specific method in recovering its costs or require GSA to establish a price for an individual product that will recover all of the costs associated with selling that product. Accordingly, GSA officials believe that they are complying with the full cost recovery requirement mandated in 40 U.S.C. 756, if the revenues for all products and services sold through its General Supply Fund are at least equal to the total cost of operating the Fund.[1] In fiscal years 1997 and 1998, GSA's audited financial statements showed that the Fund's revenues exceeded its operating expenses. Because the statute does not specify how GSA should implement full cost recovery, does not require that GSA must recover cost on an item-by-item

[1] The General Supply Fund, under the control and direction of the GSA Administrator, is used to finance, on a reimbursable basis, a national supply system for federal agencies. This system includes four business lines, under one of which retail packaging products are sold.

basis, and states that cost should be recovered so far as practicable, we believe the method GSA is using to achieve full cost recovery is within its discretion.

Our analysis of the 27 retail packaging products indicates that GSA's selling prices for the majority of these products were not sufficient to ensure that all estimated costs associated with selling each individual item were recovered from the sale of these products. Specifically, we found that the actual pricing markups applied to these products were usually lower than the individual product markups calculated by GSA's cost allocation model, which, according to GSA officials, is the most accurate estimate of how much it costs GSA to sell each item individually. For example, in fiscal year 1999, the markups used to determine selling prices for 23 of the 27 retail packaging products were less than the markups calculated by the cost allocation model. GSA officials told us that this is not unusual because their objective is to recover cost on a business line level and not on an item-by-item basis. They said that they do not use individual product markups when establishing selling prices, and it is not their objective to ensure that all costs associated with selling each individual product are recovered from the sales of those products. Instead, GSA groups similar products into what it calls a federal supply class and applies a single markup to each class to determine its product selling prices.

The federal supply class markups are determined through the use of the cost allocation model and the professional judgement of supply officials. Also, GSA officials said that even after the federal supply class pricing markup has been determined and the recommended selling price has been calculated, officials in the commodity center responsible for purchasing and managing a particular item can adjust the selling price in order to remain competitive. Given this situation, the thousands of products in its inventory, and the needed flexibility to manage its diverse products, GSA pricing officials said that it would be burdensome and impractical to implement a system that tracks each product and ensures full cost recovery on an item-by-item basis.

Background

A primary mission of GSA's Federal Supply Service (FSS) is to ensure that the service and supply needs of federal agencies are efficiently and effectively met at the least cost to the taxpayer. To accomplish this mission, FSS operates four business lines--supply and procurement, vehicle acquisition and leasing, property management, and travel and transportation. These business lines operate under the General Supply Fund, and each is composed of smaller components. For example, the supply and procurement line consists of three methods of supply or programs--schedules, special order, and stock. This report pertains primarily to the stock program in which FSS purchases about 19,000 common-use products, places them into its inventory, and then resells the products to federal agencies and other customers.[2] Products sold through the stock program include tools, paints, photocopy paper, pens, pencils, cleaning products, boxes, envelopes, and shipping sacks.

Among the boxes, envelopes, and shipping sacks offered through FSS' stock program are 27 types of these products, which collectively are referred to as retail packaging products. These products are included in 7 of the 271 classes of products sold under the stock program. FSS' sales of retail packaging products began to rise several years ago after the Postal Service approached GSA with a proposal to buy these and other products from GSA when GSA offered the best value. In fiscal year 1995, FSS sold $3.4 million in retail packaging products to the Postal Service; and by 1998 this amount had increased to $6.8 million, or about 73 percent of total sales for these products.

FSS is industrially funded, which means that generally the costs of the products and services sold to federal agencies and other customers and the costs of operating FSS' programs are to be recouped from the prices charged. GSA's consolidated financial statements, which have received unqualified opinions from independent auditors, demonstrate whether revenues exceed expenses. As part of the product pricing process, FSS considers actual costs and revenues from the accounting system, projected budgetary costs, and other costs, such as depreciation, that are associated with operating the overall Supply and Procurement business line and then assigns these costs to each of the three methods of supply--schedule, special order, and stock. Prices for products and services sold through each supply method are determined differently. In the stock program, a major part of the pricing process involves the use of a computer-based model that calculates pricing markups for groups of products according to their procurement, storage, handling, and transportation costs. FSS centrally calculates recommended selling prices on a semiannual basis for products sold through the stock program. The prices become effective on the first day of October and April. However, item managers can adjust the recommended selling price for any product at any time.

[2] For purposes of the General Supply Fund, the term "federal agency" is defined in 40 U.S.C. 472 as any executive agency or any establishment in the legislative or judicial branch of the government except the Senate, House of Representatives, and the Architect of the Capitol. Other entities, such as the Postal Service, are also authorized to purchase products and services from GSA.

GSA operates four major distribution centers located in Burlington, NJ; Palmetto, GA; Fort Worth, TX; and Stockton, CA; and three smaller centers located in Franconia, VA; Chicago, IL; and Auburn, WA, to receive, store, and ship products purchased by federal agencies through the stock program. In addition, there are 19 GSA Express Stores located throughout the world, where customers can purchase and pick up products. In fiscal year 1998 total sales for the stock program were $817 million. During this same year, retail packaging product sales totalled $9.3 million, and about 73 percent of these sales were made to the U.S. Postal Service.

Scope and Methodology

To accomplish our objectives, we reviewed the applicable statutory provision, 40 U.S.C. 756, and GSA's pricing policy and practices relating to products sold by GSA through the FSS Supply and Procurement Program. We obtained information on how the computer model was used to establish product prices, including how it assigned direct and indirect costs associated with selling each product. We also discussed the pricing and management of retail packaging products with GSA officials from FSS' headquarters in Arlington, VA, and several field locations involved in pricing or distributing retail packaging products to customer agencies.

We did our work between November 1998 and May 1999, in accordance with generally accepted government auditing standards. Appendix I provides more details about our objectives, scope, and methodology. We requested comments on a draft of this report from GSA's Administrator and the Postmaster General. GSA officials orally provided technical comments, which we incorporated in the final report. The Postal Service had no comments.

GSA Is Not Required to Recover Costs on an Item-by-Item Basis

The statutory provision related to product pricing and cost recovery, 40 U.S.C. 756, does not require GSA to recover its costs associated with selling products on an item-by-item basis and does not specify how GSA should implement full cost recovery. The statute gives GSA wide latitude in how to recover its costs. It is GSA's view that as long as the revenues obtained from all products and services sold under the General Supply Fund cover the expenses of operating the Fund, GSA is complying with the law.

The full cost recovery requirement became effective in 1988, after Congress amended 40 U.S.C. 756 (a) by adding language that provides for industrial funding of FSS and authorizes full cost recovery of the products and services purchased by federal agencies and other customers.[3]

[3] Public Law 100-202, 101 Stat.1329-427 (1987) amended 40 U.S.C. 756(a) by adding subsection (a)(3), which states that the general supply fund shall be available for paying other direct costs and indirect

Subsection (b) of this provision identifies the purchase price, transportation, and direct and indirect costs associated with contracting, handling, and distributing products as the costs that GSA should recoup through its selling prices.[4] However, the law does not require that GSA use a specific method in recovering its costs or require GSA to establish a price for individual products that will recover all of the costs associated with selling each product on an item-by-item basis. The statute provides that GSA is to fix its product prices at levels to recover, so far as practicable, the applicable purchase price, transportation, and other direct and indirect costs associated with selling the products.

Since the inception of industrial funding GSA has interpreted the statute as providing it with considerable discretion in determining how to achieve full cost recovery. GSA's 1988 Industrial Funding Implementation Plan[5] recognized that the legislation provided a great deal of flexibility. GSA officials said that the language of the statute, which provides that prices should be fixed at levels to recover so far as practicable all applicable purchase price and transportation and other direct and indirect costs associated with the products it sells, suggests that Congress recognized GSA should have latitude in establishing product prices and could not, in all cases, recover the costs associated with selling each product.

Officials from GSA's Office of General Counsel also told us that a private company challenged GSA's interpretation of the full cost recovery statute in federal district court and they said GSA won this lawsuit.[6] It should be noted, however, that the court did not address the claim that GSA's pricing methodology failed to comply with 40 U.S.C. 756(b). The Court dismissed the complaint on the grounds that the plaintiff had failed to establish that it had suffered an injury or that it was an intended beneficiary of the statute. The United States Court of Appeals affirmed the lower court's finding.

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costs that are reasonably related to contracting, procurement, inspection, storage, management, distribution, and accountability of property and nonpersonal services provided by the General Services Administration.

[4] Because 40 U.S.C. 756 identifies the specific costs that GSA should recover when selling products and services under the General Supply Fund, the statute takes precedence over OMB Circular No. A-25, which establishes federal policy regarding fees assessed for government services and for sale or use of government goods and resources.

[5] The 1987 amendment to 40 U.S.C. 756 required that GSA prepare by Feb. 15, 1988, an Industrial Funding Implementation Plan that (1) fully described and explained the accounting system (including the pricing and cost allocation methodology for products and services) to be used for such implementation and (2) contained a schedule for completing implementation of full cost recovery.

[6] T & S Products, Inc. v. United States Postal Service, General Services Administration, No. 94-896, 1994 U.S. Dist. Lexis 20751 at *1 (D.D.C. May 26, 1994;) aff.d 68 F. 3d 510 (D. C. Cir. 1995).

GSA asserts that it is complying with the full cost recovery requirement mandated in the law as long as the revenues for all products and services sold through the General Supply Fund are at least equal to the costs of operating the Fund. In the two most recently completed fiscal years--1997 and 1998--GSA's audited financial statements, which FSS officials said were prepared in accordance with Federal Accounting Standards Advisory Board accounting principles, show that the General Supply Fund revenues exceeded operating expenses by $119 million and $133 million, respectively.[7] These revenues resulted from total sales of $2.8 billion in fiscal year 1997 and $2.7 billion in fiscal year 1998. Because 40 U.S.C. 756 does not specify how GSA should implement full cost recovery, does not require GSA to recover costs on an item-by-item basis, and states that costs should be recovered so far as practicable, we believe the method GSA is using to achieve full cost recovery is within its discretion.

GSA Does Not Set Prices to Recover the Costs of Selling Each Product Individually

Notwithstanding GSA's discretion under the statute, it is GSA's objective to recover costs on each of the four business lines--supply and procurement, vehicle acquisition and leasing, property management, and travel and transportation--under the General Supply Fund from the activities within each line. For example, FSS strives to recover the overall costs of operating the supply and procurement business line, which includes retail packaging products, from the sales of products and services provided under this line. However, it is not FSS' goal to recover costs on each of the programs that are operated under this business line--schedules, special order, and stock--or to recover costs on an item-by-item basis. According to FSS officials, if the revenues produced by the schedules, special order, and stock programs are at least equal to the total cost of operating the supply and procurement business line, FSS has achieved its objective. In fiscal year 1998, net income from the supply and procurement business line was $22 million.

Because FSS focuses on recovering costs at the business line level and not at the program or product level, FSS officials said that it is not surprising that the price charged for a given product will not always cover all costs associated with providing that product. On the contrary, the officials said that the price charged for many products sold through the stock program might not be sufficient to ensure that all costs associated with providing a

[7] According to FSS officials, 40 U.S.C. 491 authorizes FSS to retain revenues from the General Supply Fund generated from agencies participating in the interagency fleet management system for the purpose of replacing such motor vehicles and related equipment and supplies. Accordingly, FSS estimated that it needed to retain $135 million and $124 million of the revenues generated in 1997 and 1998, respectively, for these purposes. Consequently, there was a revenue deficit of $16 million ($119 million minus $135 million) in 1997 and a revenue surplus of $9 million ($133 million minus $124 million) in 1998.

given product are recovered from the sales of those products. Our analysis found that this was true for most of the retail packaging products sold at the prices that were in effect at the beginning of fiscal years 1997 through 1999.

We compared the actual markups that FSS used to establish selling prices for retail packaging products with the individual product markups calculated by FSS' cost allocation model. The results of our analysis show that the selling prices established at the beginning of fiscal year 1997 for all of the 22 retail packaging products for which we could calculate full cost recovery prices were insufficient to fully recover FSS' estimated costs of selling these products. At the beginning of fiscal year 1998, 18 of the 27 retail packaging products, 67 percent, were priced at amounts insufficient to recover all associated selling costs. At the beginning of fiscal year 1999, 23 of 27 (85 percent) product prices were initially established at levels that would not fully recover all estimated costs.

Our analysis also showed that both the dollar and percentage differences between the selling prices and the estimated full cost recovery prices for retail packaging products were generally greater in 1997 than in the next 2 years. A dramatic example was the video cassette mailer. In dollars, the full cost recovery price was higher than the selling price at the beginning of each fiscal year for this product by $356.26 in 1997, $0.94 in 1998, and $2.72 in 1999. FSS officials told us that the difference between a product's selling price and its full cost recovery price is influenced by several factors, including the cost price[8] of the product, historical sales, and projected sales. These officials explained that if a product has low projected sales, the cost allocation model calculates a higher recommended markup than it would if that product had higher projected sales. This occurs because a product with low projected sales has fewer units sold to help absorb the assigned costs. The FSS officials also said that in 1997, some retail packaging products may have had low projected sales and this, in turn, could have caused the products' estimated full cost recovery prices to be significantly higher than the products' selling prices. Appendix II provides the selling prices for each of the retail packaging products offered at the beginning of the 3 fiscal years and the prices that would have resulted if FSS had used the individual product markups in determining product prices.

[8] An item's cost price is the weighted average cost of that item. The weighted average cost is calculated on the basis of the cost and quantity of a product in inventory or on order and the additional quantities expected to be ordered during the pricing period.

According to FSS officials, the price that FSS pays for each product, referred to as the cost price, is the beginning point of the pricing process. Once the cost price for each product is known, FSS pricing officials use the cost allocation model to assign program costs to each product and calculate an individual product markup. FSS officials explained that although the individual product markups represent the most accurate estimate of how much it costs to sell each product individually, these markups are not used to determine final product prices. Instead, similar products are grouped into a federal supply class, and the cost allocation model calculates an average markup for all items included in each class. These markups are then adjusted on the basis of the professional judgment of FSS pricing and supply officials, and the resulting markups become the recommended pricing markups. The recommended markups are applied to FSS' cost prices to determine the recommended selling prices.

The list of recommended product selling prices, which are set semiannually, is then sent to the appropriate commodity centers responsible for purchasing and managing the products. Item managers within each commodity center can adjust the recommended selling price for any product in order to be able to offer competitive prices. Furthermore, item managers can change the selling price for any product at any time between the semiannual pricing cycles in order to remain competitive with the private sector. According to a commodity center official, item managers typically reduce the selling price to stay competitive and raise the selling price to cover an increase in costs resulting, for example, from a higher cost charged by an FSS supplier.

According to FSS officials, although several pricing alternatives were considered when the Industrial Funding Implementation Plan was completed in 1988, FSS determined that applying a pricing markup to each federal supply class would provide the preferred pricing solution. FSS officials said because they offer thousands of products, prices on these products can change throughout the year, and FSS needs flexibility to manage its diverse product lines; it would be impractical and burdensome to monitor each product to ensure that all associated selling costs were recovered on an item-by-item basis. In 1996, GSA's Office of Inspector General completed a review of the process FSS used to price products sold through the stock program. The study concluded that FSS was generally pricing products in an efficient and effective manner, and no alternative pricing methods were identified.[9]

[9] Advisory Review on Pricing of FSS Stock Program Items, GSA OIG, Audit Report A51844/F/6/V96012 (Mar. 19, 1996).

The fact that many retail packaging products were priced at amounts that do not recover all of FSS' selling costs is not unique or unusual under the stock program. FSS pricing officials with whom we spoke estimated that two-thirds of the approximately 19,000 products sold through the stock program are priced below full cost recovery. To test this estimate, we requested that FSS query its pricing data pertaining to the stock program in February 1999. The results showed that on 78 percent of the 18,946 products, the individual product markups--which FSS officials said is the most accurate estimate of how much it costs FSS to sell each product--were higher than the markups that were actually used to determine selling prices. In 1992, we reported a similar situation in which many orders for low-value products that GSA was selling through its stock program depots were being subsidized by revenues from other products.[10]

FSS management recognizes that the stock program is facing difficult challenges, including declining sales and changes in customers' shopping habits. Therefore, beginning in January 1999, GSA initiated a study to explore strategic options for the stock program. The study group, which includes senior managers, is focusing on several issues regarding the future of its distribution centers' operations. One option is to explore the possibility of having a new FSS business model for the 21st century. As of May 1999, no decisions had been made on what changes should be made to the stock program, and time frames for making these decisions had not been established. In our prior work, we reported that the Department of Defense (DOD) also has examined its distribution system and achieved some success in reducing the costs of providing medical and food products to its customers and in reducing the quantities of these products in its supply and distribution depots. DOD achieved this success by implementing inventory management best practices developed by the private sector. Among these best practices was the use of direct delivery, whereby the private vendor delivers products directly to the customer instead of to a DOD warehouse.[11]

FSS Applies an Additional Transportation Markup to Retail Packaging Products

Although the costs FSS incurs in transporting products to its customers are included in the pricing process described above, FSS applies an additional 7-percent charge to retail packaging products to cover the increased transportation costs incurred on these products. According to FSS officials, FSS sometimes incurs increased transportation costs

[10] General Services Administration: Increased Direct Delivery of Supplies Could Save Millions (GAO/GGD-93-32, Dec. 28, 1992).

[11] Inventory Management: Greater Use of Best Practices Could Reduce DOD's Logistics Costs (GAO/T-NSIAD-97-214, July 24, 1997).

because many of the retail packaging products ordered by the Postal Service are shipped via the mail, and this mode of transportation is not generally the most economical available to FSS. FSS uses the mail because a written agreement between GSA and the Postal Service stipulates that, when possible, orders shipped to Postal installations will be mailed.

Because the Postal Service was buying most of FSS' retail packaging products, officials became concerned that the prices charged for these products were not sufficient to cover the increased cost of shipping them via the mail. Consequently, a one-time limited study of the transportation cost on retail packaging products was completed in March 1995. On the basis of this study, FSS began to apply an additional 7-percent markup to retail packaging products sold in fiscal year 1997 and thereafter.

We attempted to verify the basis for this surcharge by reviewing the FSS transportation cost study. However, we found that there was insufficient documentation to allow us to determine the specific time period of the study, the sample size, or the methodology that was used. Given that we could not independently verify the merits of the 7-percent surcharge, we did a limited analysis of the costs of shipping retail packaging products using FSS-supplied data on orders that were shipped from three distribution centers.

On these orders, we compared the actual shipping costs of retail packaging products with the costs that FSS would have incurred if a more economical mode of transportation had been used. Our analysis showed that at two of the three locations the 7-percent surcharge used by FSS exceeded the added transportation costs associated with retail packaging products. Specifically, at the Fort Worth and Franconia distribution centers, we found that a 4-percent and 6-percent surcharge, respectively, would have covered the additional transportation costs for the retail packaging products included in our analysis. However, at the Burlington Distribution Center, we found that a surcharge of approximately 10 percent would have been necessary to fully cover the additional transportation costs on the products we reviewed. As noted above, our analysis of transportation costs was limited and was conducted only to get a rough idea about the accuracy of FSS' 7-percent surcharge. Therefore, the results of our analysis cannot be projected to the universe of retail packaging products shipped by each center or sold by FSS. Appendix I provides more details on our methodology for analyzing transportation costs and the orders that we reviewed.

Conclusions

The applicable federal statute gives GSA considerable discretion in determining how it is to achieve full cost recovery on products and services sold through the General Supply Fund. Consequently, GSA is not required to, nor does it, price all of its products at levels that will ensure that all costs associated with selling each item individually are recovered from the sale of the product. The prices that GSA set centrally for most of the retail packaging products it sold in fiscal years 1997, 1998, and 1999 were not sufficient to recover all estimated costs associated with selling each individual product. Nevertheless, we agree with GSA that the method it has chosen to achieve full cost recovery is within its discretion under the statute as long as the revenues obtained from all the products and services sold under the General Supply Fund cover the expenses of operating the fund.

On the other hand, a question that remains unanswered is whether GSA should sell the majority of its products at prices that do not recover all associated selling costs. GSA's ongoing study of its stock program may shed some light on this issue, if the study specifically addresses the costs and benefits of the stock program to GSA and its customers.

Agency Comments

On June 9, 1999, FSS Assistant Commissioners for Business Management and Marketing and the Office of Distribution Management, their related staff, and the Special Assistant to the FSS Controller provided oral comments on a draft of this report. They agreed with the results of our analysis and the message of the report. They also provided technical comments, which we incorporated into this report to improve the clarity of our description of the General Supply Fund and the cost allocation model. On June 15, 1999, the U.S. Postal Service's liaison to GAO said that the Service had no comments on a draft of this report.

We are sending copies of this report to Senator George V. Voinovich, Chairman, and Senator Richard Durbin, Ranking Minority Member, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, Senate Committee on Governmental Affairs; Representative Jim Kolbe, Chairman, and Representative Steny H. Hoyer, Ranking Minority Member, Subcommittee on Treasury, Postal Service and General Government, House Committee on Appropriations; Representative Steve Horn, Chairman, and Representative Jim Turner, Ranking Minority Member, Subcommittee on Government Management, Information and Technology, House Committee on Government Reform; Senator Kay Bailey Hutchinson; the Honorable David J. Barram, Administrator, General Services Administration; and Mr. William J. Henderson, Postmaster General. We will also send copies to other interested congressional committees and subcommittees and make copies available to others on request.

Major contributors to this report are acknowledged in appendix III. If you or your staffs have any questions, please contact me on (202) 512-8387 or at ungarb.ggd@gao.gov.

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Abbreviations

FSS	Federal Supply Service
GSA	General Services Administration
USPS	U.S. Postal Service
DOD	Department of Defense

Objectives, Scope, and Methodology

Our objectives were to determine (1) whether the General Services Administration (GSA) is required by law to set its prices for retail packaging products at levels sufficient to ensure that all selling costs are recovered on each item and (2) whether GSA's selling prices for these products do recover all costs. In doing our work, we primarily performed audit work at GSA's Federal Supply Service (FSS) headquarters located in Arlington, VA. We also performed audit work at the FSS Office Supplies and Paper Products Center in New York, NY; the Southwestern Distribution Center in Fort Worth, TX; the Northeast Distribution Center in Burlington, NJ; and a Forward Supply Point in Franconia, VA. In addition, we interviewed an official from T&S Products, a private company that competes with GSA to supply retail packaging products to the United States Postal Service (USPS).

To meet the first objective, we reviewed the applicable statutory provision, 40 U.S.C. 756, relating to the pricing of products and services that FSS sells to federal agencies and other customers under the General Supply Fund. We also reviewed a court case in which a private company sued GSA alleging that GSA's pricing of retail packaging products was in violation of 40 U.S.C. 756. Additionally, we met with officials from GSA's Office of General Counsel to discuss the statutory requirements pertaining to product pricing. Finally, we reviewed and summarized a prior GSA Office of Inspector General report dealing with the subject of product pricing.

To meet our second objective, we assessed FSS' pricing policy and procedures pertinent to retail packaging products and other items sold through the stock and procurement business line. We determined whether the pricing policy and procedures were within GSA's discretion under 40 U.S.C. 756(b), which provides that product prices be fixed at levels so as to recover, so far as practicable, the applicable purchase price, and transportation and other direct and indirect costs associated with selling the products. We examined how FSS determined prices for retail packaging products in fiscal years 1997, 1998, and 1999.

In completing our examination, we reviewed how the cost allocation model was used in the product pricing process and the assumptions and data that were used in determining the final product prices. We then determined whether the prices set for retail packaging products at the beginning of fiscal years 1997, 1998, and 1999 were sufficient to recover, so far as practicable, the estimated costs associated with selling each item. We did this by using FSS accounting and cost data, including the weighted average cost price for each product, individual product markups calculated by FSS' cost allocation model, and the actual product selling prices, as of the beginning of each fiscal year.

Specifically, we compared the selling prices for each of the retail packaging products with the prices that would have been charged if FSS officials had applied the individual product markups. Our analysis assumed that the individual product markups represent the most accurate estimates of what it actually costs FSS to sell each product. We used the individual product markups and selling prices for products ordered through FSS' Customer Supply Centers because a large majority of retail packaging products were ordered through these centers. While performing our price analyses, we conducted limited testing on a sample of the FSS cost and pricing data to determine the age, accuracy, and reasonableness of these data. We also verified FSS' cost prices for retail packaging products by reviewing samples of contracts and inventory information.

In examining the transportation costs associated with retail packaging products, we attempted to evaluate the FSS study that was completed in 1994 and its corresponding conclusion that an additional 7-percent markup should be applied to these products. Our evaluation of this study was, however, severely limited because we could not independently determine the specific time period, sample size, or methodology that was used in the study. Consequently, we tested the accuracy of the additional markup by analyzing orders provided to us by FSS officials that included retail packaging products. These orders were shipped from distribution centers located in Burlington, NJ; Fort Worth, TX; and Franconia, VA. We verified the accuracy of these orders before conducting our analyses. We examined 57 orders from Fort Worth that were shipped from January 28 through January 31, 1999, and 50 orders shipped from Franconia, VA, from January 4 through January 29, 1999. We also examined 436 orders placed with the Burlington center from February 1 through February 5, 1999. We used the placement date in analyzing the Burlington data because some files provided by FSS for this location did not specify shipping dates for the orders.

Using the data from each distribution site, we determined the total dollar value of sales, transportation costs, and the costs of using an alternative transportation method for retail packaging products. We used this methodology because GSA has an agreement with USPS that it will, when possible, ship all mailable items to Postal facilities by the U.S. mail. According to GSA officials, this method of transportation was frequently used for retail packaging products, and it is often more expensive than other methods of transportation. In analyzing the Fort Worth and

Burlington shipments we allocated the total actual and alternative transportation costs to each item on a per pound basis. For the orders shipped from Franconia, we did not have to complete this allocation because the actual transportation costs could be reconstructed from existing data. To enable us to calculate the alternative transportation cost, FSS officials provided the lowest transportation cost that FSS would have incurred if the USPS shipping requirements did not apply. We then determined the difference between the actual and alternative transportation costs and calculated the markup needed to recover the additional transportation costs for each distribution center. Because of the way the locations were selected and orders were obtained, we could not combine the results of our analysis or project them to the population of retail packaging products sold by each center or by FSS overall.

We did our work between November 1998 and May 1999, in accordance with generally accepted government auditing standards. We did not, however, validate the accuracy of all data that are included in the FSS cost allocation model, and the results of our price analysis are not projectable to all products sold by GSA. We requested comments on a draft of this report from GSA's Administrator and the Postmaster General. GSA officials orally provided technical comments, which we incorporated in the final report. The Postal Service had no comments.

Comparison of Retail Packaging Products' Selling Prices With Prices Calculated Using Full Cost Recovery Markups

Table II.1: GSA's Fiscal Year 1997 Selling Prices vs. Full Cost Recovery Prices

National stock number	Item description--quantity	FSS sell price[a]	Full cost recovery price[b]	Difference[c]	Percent difference[d]
7510-01-383-7967	Tape, with dispenser 2"X22'—6/package	$7.37	$8.40	$(1.03)	(14)
7520-01-368-3499	Stamp dispenser, plastic—25/box	3.51	3.92	(0.41)	(12)
7530-01-372-3098	White envelope 6"X9"—50/box	4.51	10.25	(5.74)	(127)
7530-01-372-3099	White envelope 9"X12"—50/box	5.47	9.78	(4.31)	(79)
7530-01-372-3100	Green border envelope 10"X13"—50/box	5.66	14.37	(8.71)	(154)
7530-01-372-3104	White envelope 6"X9"—250/box	14.97	22.46	(7.49)	(50)
7530-01-372-3113	White envelope 9"X12"—250/box	18.14	21.64	(3.50)	(19)
7530-01-372-3114	Green border envelope 10"X13"—250/box	22.54	24.72	(2.18)	(10)
8105-00-281-1169	Shipping sack 14-1/4"X20"—50/package	17.93	21.79	(3.86)	(22)
8105-00-281-1436	Shipping sack 10-1/2"X16"—100 sacks	23.12	28.03	(4.91)	(21)
8105-01-385-7246	Shipping sack 6"X10"—50/package	8.60	258.18	(249.58)	(2,902)
8105-01-385-7396	Shipping sack 8-1/2"X12"—100/package	19.79	112.03	(92.24)	(466)
8105-01-385-7584	Shipping sack 10-1/2"X16"—50/package	16.58	67.22	(50.64)	(305)
8105-01-386-2181	Video cassette mailer—25/package	15.16	371.42	(356.26)	(2,350)
8105-01-386-2189	Audio cassette mailer—25/package	5.66	102.57	(96.91)	(1,712)
8105-01-386-2202	Diskette mailer—25/package	9.65	Not available	Not available	Not available
8105-01-386-2209	Shipping sack 6"X10"—250/package	37.20	115.37	(78.17)	(210)
8105-01-386-2217	Shipping sack 8-1/2"X12"—50/package	10.48	270.45	(259.97)	(2,481)
8105-01-434-3492	Photo mailer 9-3/4"X12"—25/package	Not available	Not available	Not available	Not available
8110-01-386-2192	Square mailing tube 24"X3"X3"—15/bundle	19.24	Not available	Not available	Not available
8110-01-386-2214	Square mailing tube 36"X3"X3"—15/bundle	20.75	Not available	Not available	Not available
8115-01-357-9995	Shipping box 18"X12-1/2"X3"—15/bundle	14.84	16.93	(2.09)	(14)
8115-01-357-9996	Shipping box 8"X8"X8"—15/bundle	8.00	11.64	(3.64)	(46)
8115-01-357-9997	Shipping box 15"X12"X10"—15/bundle	17.18	19.26	(2.08)	(12)
8115-01-364-9492	Shipping box 20"X14"X10"—15/bundle	22.39	25.29	(2.90)	(13)
8115-01-386-2238	Shipping box 20"X20"X20"—15/bundle	35.91	Not available	Not available	Not available
8135-01-381-6525	Bubblewrap 16"X108'X3/16"—12/package	18.67	23.56	(4.89)	(26)

Note 1: The gain or loss for each individual product cannot be extrapolated to the total sales of that product during the fiscal year because each of the products may have been sold at different prices throughout the year, and the quantities of products sold at these different prices were not readily available.

Note 2: Parentheses denote the number is negative.

[a]Sell price effective beginning on October 1, 1996, for products sold through the Customer Supply Centers. All product selling prices are subject to change in April of each year and may be changed throughout the year by item managers.

[b]The full cost recovery price represents the cost price plus the individual product pricing markup as calculated by FSS' cost allocation model. According to FSS, the individual product markup represents the most accurate estimate of how much it costs FSS to sell each item individually.

[c]According to FSS, the higher difference between a product's sell price and its full cost recovery price may be due to low projected sales volume. The costs allocated to each unit are higher on a product with low projected sales than on a product with high projected sales because the product with low projected sales has fewer units sold to absorb the costs. As a result, a low sales projection for a product could cause that product's full cost recovery price to be significantly higher than its selling price.

[d]The difference as a rounded percentage of the FSS sell price.

Source: GAO analysis of FSS' cost and sell prices and markups for retail packaging products.

Table II.2: GSA's Fiscal Year 1998 Selling Prices vs. Full Cost Recovery Prices

National stock number	Item description--quantity	FSS sell price[a]	Full cost recovery price[b]	Difference[c]	Percent difference[d]
7510-01-383-7967	Tape, with dispenser 2"X22'—6/package	$7.61	$6.23	$1.38	18
7520-01-368-3499	Stamp dispenser, plastic—25/box	3.99	6.63	(2.64)	(66)
7530-01-372-3098	White envelope 6"X9"—50/box	8.98	10.20	(1.22)	(14)
7530-01-372-3099	White envelope 9"X12"—50/box	10.18	12.20	(2.02)	(20)
7530-01-372-3100	Green border envelope 10"X13"—50/box	9.84	13.44	(3.60)	(37)
7530-01-372-3104	White envelope 6"X9"—250/box	27.30	24.58	2.72	10
7530-01-372-3113	White envelope 9"X12"—250/box	33.35	28.39	4.96	15
7530-01-372-3114	Green border envelope 10"X13"—250/box	37.69	32.60	5.09	14
8105-00-281-1169	Shipping sack 14-1/4"X20"—50/package	19.93	20.78	(0.85)	(4)
8105-00-281-1436	Shipping sack 10-1/2"X16"—100 sacks	28.13	28.81	(0.68)	(2)
8105-01-385-7246	Shipping sack 6"X10"—50/package	8.89	12.63	(3.74)	(42)
8105-01-385-7396	Shipping sack 8-1/2"X12"—100/package	16.46	16.67	(0.21)	(1)
8105-01-385-7584	Shipping sack 10-1/2"X16"—50/package	16.08	23.72	(7.64)	(48)
8105-01-386-2181	Video cassette mailer—25/package	11.18	12.12	(0.94)	(8)
8105-01-386-2189	Audio cassette mailer—25/package	5.03	6.32	(1.29)	(26)
8105-01-386-2202	Diskette mailer—25/package	7.55	8.83	(1.28)	(17)
8105-01-386-2209	Shipping sack 6"X10"—250/package	29.32	28.14	1.18	4
8105-01-386-2217	Shipping sack 8-1/2"X12"—50/package	10.58	16.91	(6.33)	(60)
8105-01-434-3492	Photo mailer 9-3/4"X12"—25/package	12.27	11.49	0.78	6
8110-01-386-2192	Square mailing tube 24"X3"X3"—15/bundle	17.49	21.35	(3.86)	(22)
8110-01-386-2214	Square mailing tube 36"X3"X3"—15/bundle	18.85	23.21	(4.36)	(23)
8115-01-357-9995	Shipping box 18"X12-1/2"X3"—15/bundle	10.82	10.78	0.04	0
8115-01-357-9996	Shipping box 8"X8"X8"—15/bundle	5.32	7.58	(2.26)	(42)
8115-01-357-9997	Shipping box 15"X12"X10"—15/bundle	9.90	11.56	(1.66)	(17)
8115-01-364-9492	Shipping box 20"X14"X10"—15/bundle	14.05	15.27	(1.22)	(9)
8115-01-386-2238	Shipping box 20"X20"X20"—15/bundle	27.36	26.07	1.29	5
8135-01-381-6525	Bubblewrap 16"X108'X3/16"—12/package	17.45	16.14	1.31	8

Note 1: The gain or loss for each individual product cannot be extrapolated to the total sales of that product during the fiscal year because each of the products may have been sold at different prices throughout the year, and the quantities of products sold at these different prices were not readily available.

Note 2: Parentheses denote the number is negative.

[a]Sell price effective beginning on October 1, 1997, for products sold through the Customer Supply Centers. All product selling prices are subject to change in April of each year and may be changed throughout the year by item managers.

[b]The full cost recovery price represents the cost price plus the individual product pricing markup as calculated by the FSS' cost allocation model. According to FSS, the individual product markup represents the most accurate estimate of how much it costs FSS to sell each item individually.

[c]According to FSS, the higher difference between a product's sell price and its full cost recovery price may be due to low projected sales volume. The costs allocated to each unit are higher on a product with low projected sales than on a product with high projected sales because the product with low projected sales has fewer units sold to absorb the costs. As a result, a low sales projection for a product could cause that product's full cost recovery price to be significantly higher than its selling price.

[d]The difference as a rounded percentage of the FSS sell price.

Source: GAO analysis of FSS' cost and sell prices and markups for retail packaging products.

Table II.3: GSA’s Fiscal Year 1999 Selling Prices vs. Full Cost Recovery Prices

National stock number	Item description--quantity	FSS sell price[a]	Full cost recovery price[b]	Difference[c]	Percent difference[d]
7510-01-383-7967	Tape, with dispenser 2”X22’—6/package	$7.97	$6.44	$1.53	19
7520-01-368-3499	Stamp dispenser, plastic—25/box	4.35	7.63	(3.28)	(75)
7530-01-372-3098	White envelope 6”X9”—50/box	2.44	3.42	(0.98)	(40)
7530-01-372-3099	White envelope 9”X12”—50/box	4.17	6.45	(2.28)	(55)
7530-01-372-3100	Green border envelope 10”X13”—50/box	5.17	7.22	(2.05)	(40)
7530-01-372-3104	White envelope 6”X9”—250/box	10.66	11.14	(0.48)	(5)
7530-01-372-3113	White envelope 9”X12”—250/box	16.73	17.01	(0.28)	(2)
7530-01-372-3114	Green border envelope 10”X13”—250/box	18.96	18.89	0.07	0
8105-00-281-1169	Shipping sack 14-1/4”X20”—50/package	20.00	21.97	(1.97)	(10)
8105-00-281-1436	Shipping sack 10-1/2”X16”—100 sacks	23.66	25.64	(1.98)	(8)
8105-01-385-7246	Shipping sack 6”X10”—50/package	8.57	13.28	(4.71)	(55)
8105-01-385-7396	Shipping sack 8-1/2”X12”—100/package	17.25	18.70	(1.45)	(8)
8105-01-385-7584	Shipping sack 10-1/2”X16”—50/package	17.09	25.27	(8.18)	(48)
8105-01-386-2181	Video cassette mailer—25/package	12.34	15.06	(2.72)	(22)
8105-01-386-2189	Audio cassette mailer—25/package	5.01	7.84	(2.83)	(56)
8105-01-386-2202	Diskette mailer—25/package	7.58	9.16	(1.58)	(21)
8105-01-386-2209	Shipping sack 6”X10”—250/package	36.24	35.82	0.42	1
8105-01-386-2217	Shipping sack 8-1/2”X12”—50/package	10.63	18.18	(7.55)	(71)
8105-01-434-3492	Photo mailer 9-3/4”X12”—25/package	8.68	9.81	(1.13)	(13)
8110-01-386-2192	Square mailing tube 24”X3”X3”—15/bundle	10.21	12.41	(2.20)	(22)
8110-01-386-2214	Square mailing tube 36”X3”X3”—15/bundle	11.51	13.70	(2.19)	(19)
8115-01-357-9995	Shipping box 18”X12-1/2”X3”—15/bundle	11.12	12.80	(1.68)	(15)
8115-01-357-9996	Shipping box 8”X8”X8”—15/bundle	6.30	10.77	(4.47)	(71)
8115-01-357-9997	Shipping box 15”X12”X10”—15/bundle	12.19	14.75	(2.56)	(21)
8115-01-364-9492	Shipping box 20”X14”X10”—15/bundle	16.32	18.42	(2.10)	(13)
8115-01-386-2238	Shipping box 20”X20”X20”—15/bundle	32.76	36.74	(3.98)	(12)
8135-01-381-6525	Bubblewrap 16”X108’X3/16”—12/package	18.98	18.02	0.96	5

Note 1: The gain or loss for each individual product cannot be extrapolated to the total sales of that product during the fiscal year because each of the products may have been sold at different prices throughout the year, and the quantities of products sold at these different prices were not readily available.

Note 2: Parentheses denote the number is negative.

[a]Sell price effective beginning on October 1, 1998, for products sold through the Customer Supply Centers. All product selling prices are subject to change in April of each year and may be changed throughout the year by item managers.

[b]The full cost recovery price represents the cost price plus the individual product pricing markup as calculated by FSS’ cost allocation model. According to FSS, the individual product markup represents the most accurate estimate of how much it costs FSS to sell each item individually.

[c]According to FSS, the higher difference between a product’s sell price and its full cost recovery price may be due to low projected sales volume. The costs allocated to each unit are higher on a product with low projected sales than on a product with high projected sales because the product with low projected sales has fewer units sold to absorb the costs. As a result, a low sales projection for a product could cause that product’s full cost recovery price to be significantly higher than its selling price.

[d]The difference as a rounded percentage of the FSS sell price.

Source: GAO analysis of FSS’ cost and sell prices and markups for retail packaging products.

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Acknowledgments

In addition to the individual named above, Gerald Stankosky, James Cooksey, William Dowdal, Jeff Kaser, Alan Belkin, and Susan Michal-Smith also made key contributions to this report.

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