U.S. GOVERNMENT PRINTING OFFICE
KEEPING AMERICA INFORMED

AUDIT REPORT 09-02

GPO'S PASSPORT PRINTING COSTS

December 22, 2008

OFFICE OF INSPECTOR GENERAL

U.S. GOVERNMENT PRINTING OFFICE
KEEPING AMERICA INFORMED
WASHINGTON, DC 20401

Memorandum

OFFICE OF THE INSPECTOR GENERAL

DATE: December 22, 2008

REPLY TO ATTN OF: Assistant Inspector General for Audits and Inspections

SUBJECT: Final Report on Audit of GPO's Passport Printing Costs
Report Number 09-02

TO: Chief Financial Officer
Managing Director, Security and Intelligent Documents

Enclosed please find the subject final report. Please refer to the Executive Summary for the overall audit results. Our evaluation of your response has been incorporated into the body of the report and the response is included in its entirety at Appendix C. We consider management's actions responsive to each of the report recommendations. Recommendations one and five will be closed upon issuance of this report. Recommendations two, three, and four will remain open pending the finalization of the five-year Capital Plan for Passports, the addendum to the GPO/Department of State Memorandum of Understanding regarding pricing and cost review, and the updated passport pricing structure. Please notify us when those actions are complete. The status of each recommendation upon issuance of this report is included in Appendix D. The final report distribution is in Appendix E.

We appreciate the courtesies extended to the audit staff. If you need additional information or would like to arrange a meeting to discuss this final report, please contact Mr. Karl Allen, Supervisory Auditor at (202) 512-0277, or me at (202) 512-2009.

Kevin J. Carson

Kevin J. Carson
Assistant Inspector General for Audits and Inspections

Enclosure

cc:
Chief of Staff
Chief Management Officer
General Counsel

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Office of Inspector General

Report Number 09-02 **December 22, 2008**

GPO's Passport Printing Costs

Executive Summary

Background. The Office of Inspector General (OIG) has completed an audit of passport printing costs at the Government Printing Office (GPO). GPO is the sole source for producing, storing, and delivering blank U.S. passport books (passports) for the Department of State (DOS). GPO produced an average of nearly 2.3 million passports each month during the first eight months of Fiscal Year (FY) 2008.[1] Specifically, through May of FY 2008, GPO produced a total of 18.6 million passports and realized revenue from passport sales of more than $275 million, including $71.5 million in net income. Recently, Congress and the news media have questioned the price of passports charged to the American public, and have also questioned GPO about the legality and reasonableness of the net income derived from passport sales to the DOS.

Objectives. The overall audit objective was to assess GPO's basis for establishing the price the agency charges the DOS for each blank passport book produced. Specific objectives included determining whether GPO had an effective passport cost accumulation and allocation methodology in place that would support the price charged to DOS for each passport produced, and if the income derived from passport sales was allowable and reasonable under applicable requirements and guidelines.

Results of Audit. In conjunction with the DOS, GPO established a price of $14.80[2] that it charges DOS for each passport produced. The price of $14.80 includes the cost of material, labor, overhead, inventory, and future capital expansion. GPO established the price in accordance with 44 U.S.C. § 309, "Revolving fund for operation and maintenance of Government Printing Office" (Title 44). The price was mutually agreed to with the DOS through a Memorandum of Understanding (MOU). We analyzed GPO's passport production financial activities through May of FY 2008 and specifically tested GPO's direct passport costs by tracing reported costs for materials, labor, and direct overhead to original source documents. We concluded that GPO had adequate documented support for all direct costs charged to passports and had a cost accumulation process that was sufficient for the Agency to base its passport price.

We identified two specific areas where GPO can improve the accountability and transparency of its passport costing process to better prepare the Agency for any future audits or reviews by outside entities and to promote good customer relations with the DOS. First, through the May 2008 audit time period, we found that GPO generated

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[1] From October 2007 through May 2008.

[2] The DOS currently charges the public $100 for an adult passport. This fee, effective February 1, 2008, for persons 16 years and older, consists of $75 for the passport application and $25 for processing.

excess cash from passport sales to DOS beyond what was necessary to recover costs and provide for mutually agreed upon future capital expansion. This occurred because GPO did not revise its original passport pricing structure and did not reach final agreement with the DOS on a capital investment plan to earmark the excess cash. Through May of FY 2008, GPO generated over $43 million in excess cash from passport sales. As further explained in this report, due to GPO's business-like revolving fund under Title 44 and its accrual basis of accounting, it is legal and expected for GPO to carry profits or losses in any given fiscal year depending on a variety of factors as it determines how best to set rates and prices to reimburse its full costs of operation.

Second, we found that GPO, at its discretion, changed its indirect overhead cost allocation methodology for passport costs. However, it did so without documenting the justification and analysis for the change. The Agency increased the amount of indirect overhead allocated to passport costs from 5.65 percent or $4 million in FY 2007, to 52 percent or $40 million through May FY 2008.

In light of these findings, we recommended that GPO:

- Finalize its capital investment plan and proposed addendum to the MOU with DOS regarding passport pricing, to better account for the excess cash generated from passport sales.

- Document and explain the Agency's change in the indirect overhead cost rate allocation to the cost of passports to explain the increase in indirect overhead allocated to passports.

- Revise the passport pricing structure to be more reflective of the current passport costing and production process.

In addition, we made other observations during the audit in the areas of passport managerial costing policies and procedures documentation, and the immaterial overstatement of labor costs that were presented for management's consideration.

Recommendations. A total of five recommendations were made to GPO management which, if implemented, will help GPO improve the accountability and transparency of its passport costing process to better prepare the Agency for any future audits or reviews by outside entities and also promote good customer relations with the DOS.

Management's Response. GPO Management concurred with each of the report's recommendations and has either already taken or plans to take responsive corrective actions.

Introduction

GPO produces, stores, and delivers U.S. passports for the DOS. In FY 2007, GPO produced a total of 20,606,000 passports for DOS. This was a significant increase from the 13,661,000 passports produced by GPO in FY 2006 and was attributable to both an unprecedented demand for passports and the replacement of the legacy passport with the new electronic passport. The electronic passport contains a computer chip and other security features required by the DOS. Approximately 14,815,000, or 72 percent of the 20,606,000 passports produced by GPO in FY 2007, were the new electronic passports.

Title 44

GPO establishes the price that it charges DOS for each passport in accordance with Title 44 and through a formal Memorandum of Understanding (MOU) with DOS.

- Title 44. Two of the key requirements of Title 44 are: (1) GPO must fund its programs and operations through a self-sustaining, business-type revolving fund that GPO reimburses at rates and prices that recover the full cost of goods and services delivered to customers; and (2) GPO must prepare a system of accounts and financial reports following the accrual basis of accounting in which it recognizes revenues when earned, and expenses when incurred, without regard to the timing of the receipt or disbursement of cash.

- GPO/DOS Memorandum of Understating (MOU). In November 2003, GPO and DOS entered into an MOU that established the obligations and protocols for each agency to follow in connection with production of passports. In the most recent version of the MOU (December 2007) DOS and GPO agreed to include in the price of passports estimated charges of the proportionate share of overhead costs for GPO and a contribution for future capital assets. The MOU requires GPO to provide DOS with a price per book annually.

The Government Accountability Office (GAO) provides guidelines for the operation of revolving funds in Volume IV of its Principles of Federal Appropriations Law.[3] GAO describes a revolving fund as a self-sustaining, business-like activity in which a buyer/seller relationship exists. Unlike some other revolving funds, Title 44 does not include a periodic miscellaneous receipts payment requirement, which would require GPO to make periodic payments of any revolving fund surplus to the general fund of the Treasury. This allows GPO discretion to adjust its prices so that it can recover losses or offset profits to minimize annual losses or gains.[4]

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[3] Government Accountability Office, *Principles of Federal Appropriations Law*, Volume IV, Second Edition (March 2001), pp. 15-81 to 15-129. This document can be found at http://www.gao.gov/special.pubs/d01179sp.pdf.

[4] *See, e.g.*, Government Accountability Office (GAO) Opinion B-181714-O.M., January 3, 1975 (GAO found that the Military Sealift Command Industrial Fund could periodically adjust tariff rates to recover losses or offset profits because its statute does not provide that excess earnings be transferred to the U.S. Treasury as miscellaneous receipts).

Thus, for GPO as a self-sustaining, business-like activity, profit generation or losses can be expected. However, revolving funds are intended to operate on a break-even basis or reasonably close to it, at least over the long term.[5]

GPO Passport Costs Information

GPO uses the following systems as the platform for its system of accounts for accumulating cost data:

- Oracle Financial On-Demand
- Accounts Payable Interface (API)
- Voucher Processing and Payment System (VOPPS)
- Work in Process (WIP) System
- Cost Accounting System (COST)
- Production Reporting for Operations, Budgeting, and Expenditures (PROBE)

GPO reports all costs annually through the Agency's financial statements, as well as monthly through the GPO monthly financial package distributed to senior GPO managers. GPO has designated eight revenue-producing business units that produce goods or provide services to external customers, for which it reports business data. The GPO Business Units include:

- Official Journals of Government
- Security and Intelligent Documents
- Creative and Digital Media Services
- Customer Services
- Publication and Information Sales
- Agency Distributions
- Library Services and Content Management
- Other Operations

Business data related to passports is contained in the Security and Intelligent Documents (SID) business unit. During the audit period of October 2007 through May 2008, passports were the only source of revenue for the SID business unit. SID accumulates and reports its own profit and loss data following accrual accounting as required by Title 44. By following the accrual basis of accounting, the portion of the passport price covering the funding of capital assets (such as the GPO Secure Production Facility[6]) is recorded as revenue. The costs for the asset are then recorded as a capital asset, not an expense, and the operating expenses for the capital asset (such as depreciation) do not start until the asset is placed in operation. The result is that for the early years of the

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[5] Government Accountability Office, *Principles of Federal Appropriations Law*, Volume IV, Second Edition (March 2001), p. 15-117.

[6] The Secure Production Facility (SPF) is an alternate passport production facility that GPO established in 2008 at the NASA Stennis Space Center in Mississippi.

asset's life cycle, GPO will show a large net income, which is gradually reduced as an asset becomes operational and depreciation expenses are incurred.

GPO does not have a documented managerial costing policy. However, several Federal managerial costing standards exist. The most notable of these standards include:

- Cost Accounting Standards that the Cost Accounting Standards Board developed to achieve uniformity and consistency in the measurement, assignment, and allocation of costs to Government contracts.

- Statement of Federal Financial Accounting Standards Number 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," issued on July 31, 1995, by the Federal Accounting Standards Advisory Board.

Findings and Recommendations

Finding A. Generation of Excess Cash

Through the first eight months (October 1, 2007 to May 31, 2008) of FY 2008, GPO generated in excess of $43 million in cash from passport sales to the DOS beyond what was necessary to recover costs and provide for mutually agreed upon future capital expansion. GPO generated this excess cash because Agency management has not revised the original electronic passport pricing structure established prior to FY 2007, and did not reach final agreement with the DOS on a passport Capital Investment Strategy to earmark the excess cash—both of which GPO's MOU with the DOS requires. The excess cash was generated primarily because of (1) the higher than anticipated demand from the DOS for the production of passports during FY 2008, (2) cost under-runs on the Secure Production Facility (SPF), and (3) the lack of a mutually agreed upon Capital Investment Plan between GPO and the DOS.

Pricing Agreement Between GPO and DOS

The December 2007 MOU between GPO and DOS states that:

> GPO will provide DOS with a price per book on an annual basis. The annual price will be determined by using an estimate of all anticipated direct and indirect costs of manufacture plus the estimated proportionate share of overhead costs for GPO, and a contribution to GPO for new investment. In addition, the price per book will include the estimated costs of any on-going and/or anticipated future capital investments to support the passport program. The current passport price is provided in Appendix H and the Current Investment Plan is provided in Appendix I.

Appendix H of the MOU states that the price for capital improvement set aside (contribution for new investment) is $1.83 for each passport book. The Current Investment Plan section (Appendix I) of the MOU has not been completed.

To date, the only capital investment project agreed to by the GPO and DOS and approved by the congressional Joint Committee on Printing (JCP) was the SPF at the Stennis Space Center in Mississippi. In its July 10, 2007, request to the JCP for establishing the SPF, GPO calculated that the cost to establish and finance the SPF would be $1.84 for each passport book that GPO produced with the full required amount to be accumulated by January 2008. The JCP, in its letter of approval for the SPF, states:

> The JCP authorizes financing the establishment and operation of the Stennis passport facility only as requested in the GPO letter dated July 10, 2007. GPO's proposal contemplated reimbursement by the Department of State for all costs of passport production. GPO must obtain JCP approval for additional spending on equipment or other costs in accordance with the JCP resolution adopted on April 9, 1987.

According to the GPO Chief Financial Officer (CFO), GPO and DOS also agreed that GPO would establish an inventory reserve of $35 million for which GPO decided to fund at $1.38 per each passport produced.

Excess Cash Generated

Through May of FY 2008, GPO passport production operations generated over $43 million in cash beyond that necessary to recover operational costs, establish an inventory reserve, and fund the SPF as agreed to with DOS. Table 2 provides details of the components of this excess cash.

Table 2. Excess Cash Generated by GPO Through Passport Sales Through May of FY 2008

Passport Contribution Margin	$111,612,930
Less: Overhead Allocation	(40,051,000)
Passport Net Income	71,561,930
Less: Reserved for SPF during FY 2008	(13,884,210)
Less Reserved for Inventory during FY 2008	(14,099,598)
Excess Cash	$43,578,122

In addition to the reserves for the SPF and inventory that were agreed to by DOS, GPO established two more cash restrictions specifically for passport operations: Future Capital Projects—State Department (established on April 18, 2008), and Shortfall Contingency (established on May 14, 2008) as shown in Table 3:

Table 3. Additional Cash Restrictions Applicable to Passports Through May of FY 2008

Excess Cash	$43,578,122
Less: Reserved for Future Capital Projects—State Department	(19,767,294)
Less: Reserved for Shortfall Contingency	(11,258,730)
Excess Cash After All Restrictions	$12,552,098

All of the cash generated from GPO operations was placed in the account, "Fund Balance With Treasury." The cash restrictions were not actual accounts but a way of identifying excess cash as a control to ensure that it was expended for its intended purposes. The passport contribution margin noted above does not include amounts necessary to contribute to investment in the overall GPO support infrastructure (i.e., costs to fix a leaky roof or repair an elevator). Those amounts, when considered, would reduce the amount of excess cash.

Passport Price Not Revised

GPO developed the current passport price of $14.80 prior to the start of FY 2007. The price reflected the initial production of the electronic passports and presented a significant challenge for GPO to develop because it involved much unknown information and no previous production history for basing estimates. Although the initial pricing estimate proved accurate, several factors have occurred since that time that could not only impact the price, but also contributed to the generation of excess cash. Specifically, we identified that:

- GPO produced significantly more passports than the amount on which the original price was based. Specifically, GPO based the original passport price of $14.80 per book on producing an estimated 14.2 million books annually. In FY 2007, because of an unprecedented demand, GPO produced more than 20 million books and GPO had already produced more than 18 million books through May of FY 2008.

- GPO continued to include $1.83 in the price of each passport produced for financing of the SPF, even though GPO had fully funded that facility by December 27, 2007. The MOU allows GPO to include a cost for capital asset financing in the line item of the pricing structure of each passport book. However, paragraph G.4 of the MOU states that "once the agreed upon number of books has been produced, the charge will be removed from future book orders."

- GPO continued to include $1.38 in the passport price for building up the raw materials inventory reserve, even though GPO met its desired inventory reserve level of $35,000,000 on January 28, 2008. The MOU does not address inventory reserve even though the CFO stated that GPO and DOS agreed to the $35 million reserve level.

- The original passport price of $14.80 included $1.10 per book for overhead based on an estimate of $15.6 million annually for GPO overhead. GPO changed its overhead allocation methodology in FY 2008 (see Finding B) and through May 2008, GPO allocated over $40 million in overhead to passports at $2.16 per book.

- GPO began to depreciate the SPF when the facility became operational in May 2008. However, these specific depreciation costs were not included in the overall passport price.

Uncertainty with DOS

The CFO stated that there has been much uncertainty from DOS regarding the number of passports to produce. In fact, during May 2008, while this audit was being conducted, there was a time when GPO was not producing passports because it had not received any orders from DOS. This production uncertainty has occurred even though the MOU between GPO and the DOS states that "DOS will provide GPO with a projection of the monthly delivery amount for each type of blank book shipment at least one month prior to October 1 of each year." This projection of yearly passport requirements by the DOS has not occurred. The CFO stated that because of the uncertainty in the number of passport books to produce, it has been necessary to leave the price at $14.80 to have a sufficient amount of cash on hand to cover contingencies and future capital projects.

Agreement with DOS on Capital Investment Plan not Reached

GPO did not reach agreement with the DOS on a Capital Investment Plan, as the MOU requires. In April 2008, the CFO directed that his staff establish a restricted fund for future capital projects for DOS by continuing to use the $1.83 for each passport retroactive to December 27, 2007, when GPO met the reserve for the SPF. GPO then set up a restricted fund balance for "Future Capital Projects," but did not reach agreement with the DOS as to what projects to develop.

Because of the significant amount of excess cash that GPO was generating from passport sales, it appeared that GPO was potentially charging DOS more than necessary. Although GPO officials acknowledged a large income related to passport sales, these same officials were concerned that in the midst of uncertainty in passport production, a downward adjusting of the passport price could leave GPO in an unfavorable financial position.

Corrective Actions Taken by GPO

In recent months, GPO has proactively acted to address the issue of having a significant amount of excess cash on-hand.

- In February 2008, GPO and the DOS started a bi-monthly Supply/Demand Working Group to negotiate and agree to detailed short-term production and delivery schedules and production ramp-up plans.

- In April 2008, the CFO directed that his staff establish a new restricted cash account for future capital projects.

- In June 2008, GPO and the DOS initiated a Passport Capital Investment Plan Working Group that would meet periodically to discuss and formalize plans for passport capital projects.

- The GPO Managing Director, Security and Intelligent Documents (SID) developed a proposed five-year Capital Investment Plan for passports. The plan contains a detailed listing of proposed passport capital projects with an estimated cost in excess of $203 million. The Managing Director, SID stated that both GPO and the DOS would have to approve the plan during future Working Group meetings and that once approved, GPO would adjust the passport price accordingly.

- In July 2008, the CFO developed a proposed addendum to the MOU with the DOS requiring that GPO: (1) perform semi-annual pricing reviews to ensure that the passport pricing reflects the then current costs and demand expectations; and (2) perform annual analyses to determine if GPO has either over-recovered or under-recovered its costs and to consider those costs in the price of passports on a prospective basis.

- In September 2008, GPO returned $51 million to the DOS of the amount of excess cash accumulated during FY 2008. This amount was generated because of higher than anticipated demand for passport production, cost underruns on the SPF project, lack of an agreed to Capital Investment Plan and exceeding the $35 million agreed to level for raw materials inventory.

Recommendations

The Managing Director, SID, in conjunction with the CFO, should:

1. Ensure that GPO continues its bi-monthly meetings with the DOS through the Supply/Demand Working to negotiate and agree to detailed short-term production and delivery schedules and production ramp-ups.

Management's Response. Concur. The Managing Director, SID plans to encourage, attend and foster the GPO/DOS Supply/Demand Working Group meetings and expects more defined passport production and delivery schedules to be negotiated in FY 2009. The complete text of management's response is in Appendix C.

Evaluation of Management's Response. Management's action is responsive to the recommendation. The recommendation will be closed upon issuance of this report.

2. Work with the DOS and establish a time frame for formalizing and finalizing the five-year Capital Investment Plan for Passports.

Management's Response. Concur. The Managing Director, SID met with the Deputy Assistant Secretary of State for Passport Services on November 21, 2008. During this meeting, the Deputy Assistant Secretary of State stated they were still studying specific line items on the five-year Capital Investment Plan. The Managing Director, SID fully expects that the DOS will make a decision regarding the five-year Capital Investment Plan during the month of January 2009. Following a decision, the FY09 portion of the five-year plan will be initiated (if approved by DOS) and an addendum to the MOU can be signed that defines the new passport pricing schedule in Appendix H and the approved capital expenditure plan in Appendix I (see Appendix C).

Evaluation of Management's Response. Management's planned actions are responsive to the recommendation. The recommendation is resolved but undispositioned, and will remain open for reporting purposes pending finalization of the five-year Capital Investment Plan for passports.

3. Finalize the proposed addendum to the GPO/DOS MOU.

Management's Response. Concur. The Managing Director, SID will facilitate the future discussions between DOS and GPO financial and legal experts to define processes agreeable to both parties and work to moderate an addendum to the MOU that satisfies the requirements of both organizations (see Appendix C).

Evaluation of Management's Response. Management's planned action is responsive to the recommendation. The recommendation is resolved but undispositioned, and will remain open pending finalization of the addendum to the MOU with the DOS.

4. Update the passport pricing structure taking into account the formal Capital Investment Plan for Passports, the revised indirect cost allocation rate, depreciation of the SPF, and current production estimates. Keep the pricing structure in the same format as the current costing structure.

Management's Response. Concur. The Managing Director, SID will work with the SID Comptroller and GPO's CFO to present the passport pricing documents in accurate, readable and descriptive formats that are in keeping with our current costing structure (see Appendix C).

Evaluation of Management's Response. Management's planned action is responsive to the recommendation. The recommendation is resolved but undispositioned, and will remain open pending finalization of the revised passport costing structure.

Finding B. Change in Indirect Overhead Allocation Rate

GPO could not provide sufficient documentation to support the increase from FY 2007 to FY 2008 in the indirect overhead allocated to passports. The CFO and Controller both stated that the previous year's (FY 2007) indirect overhead rate was too low because of the increased volume and growth of the SID business unit and GPO, therefore, needed a revised overhead allocation methodology to provide a more accurate and equitable distribution of costs. Despite an increase in the allocation rate from 5.65% to 51.88%, GPO did not document its justification and analysis for the change. As a result, we could not attest to the reasonableness of the more than $40 million in indirect overhead costs GPO allocated for passport production through May of FY 2008 ($2.16 for each passport). Although there was a change in the indirect overhead allocation methodology, the change did not result in any additional cost to the GPO nor did it result in an increase in the price of passports produced for the DOS.

Indirect Overhead Cost Allocation Standards

Title 44 allows GPO to reimburse its Revolving Fund for the cost of services and supplies furnished at rates that include charges for indirect overhead. Indirect costs are costs of resources jointly or commonly used to produce two or more types of outputs but are not specifically identifiable with any of the outputs. The Statement of Federal Financial Accounting Standards (SFFAS) Number 4 cites typical examples of indirect costs such as the costs of general administrative services, security, rent, employee health and recreation facilities, and operating and maintenance costs for buildings, equipment, and utilities.[7] Section 8-418.1 of the Cost Accounting Standards (CAS) states:

> (1) a business unit shall have a written statement of accounting policies and practices for classifying costs as direct or indirect which shall be consistently applied; (2) indirect costs shall be accumulated in indirect cost pools which are homogeneous; and (3) pooled costs shall be allocated to cost objectives in reasonable proportion to the beneficial or causal relationships of the pooled costs to cost objectives.

At GPO, there is an indirect cost pool that consists of the total costs from the following organizations:

- Executive Offices (for example, Office of the Public Printer and Office of the General Counsel)
- Mandated Programs (for example, the OIG and Office of Equal Employment Opportunity)
- Quality Assurance
- Finance and Administration
- Acquisitions
- Information Tech and Services
- Environmental Services

[7] Paragraph 91 of SFFAS 4.

- Human Capital
- Labor Relations
- Facilities
- Other Operations

GPO allocates the total costs from these organizations to the business units in GPO.

SFFAS 4 allows management to select the overhead allocation methodology that best meets their needs as long as they document and explain any changes:

> 144. This standard does not require the use of a particular type of costing system or costing methodology. Federal entities are engaged in a broad range of diverse operations. A costing system appropriate for one type of operation may not be appropriate for other operations. At many federal agencies, cost accounting practices are either relatively new or experimental. It is too early to tell which cost systems are best for specific types of operations. As experience and research in cost accounting progress, reporting entities and responsibility segments may find a preferred costing methodology for their operations.
>
> 145. Agency and program management is in the best position to select a type of costing system that would meet its needs. In making the selection, management should evaluate alternative costing methods and select those [methods] that provide the best results under its operating environment.
>
> 146. The standard requires that a costing methodology, once adopted, be used consistently. Consistent use provides cost information that can be compared from year to year. However, this requirement does not preclude necessary improvements and refinements to the system or methodology, as long as the effect of any change **is documented and explained [emphasis added]**. On the contrary, improvements are encouraged.

Indirect Overhead Increased In FY 2008

The amount of indirect overhead that GPO allocated to passport costs (that is, SID) increased significantly from FY 2007 to FY 2008 as the following table shows:

Table 1. Increase in Overhead Allocated to Passport Cost
FYs 2007 and 2008 through May

Fiscal Year	Amount	Rate
2007	$ 4,087,000	5.65%
2008	$40,051,000	51.88%

The CFO and Controller stated that the overhead allocation rate for FY 2007 was too low due to the increased volume and growth of the SID business unit and, therefore, the Agency had to adjust the rate beginning in FY 2008. During FY 2007, GPO allocated indirect overhead by the number of its employees. For FY 2008, GPO changed its method and began using net costs[8] as the basis for indirect overhead allocation.

Although management is allowed to select whatever overhead allocation method that best meets their needs, GPO officials did not document and explain the change as required by paragraph 146 of SFFAS 4. These officials could not provide documentation supporting: the evaluation of alternative costing methods; selection of the method that provided the best results under GPO's operating environment; evidence of the accuracy of the current method; or the briefing of the revised method and its impact on passport costing, to GPO senior management. Without documented evidence supporting management's analysis, we could not attest to the accuracy and reasonableness of the more than $40 million ($2.16 for each passport) in indirect overhead costs GPO allocated for passport production through May of FY 2008. Regardless of the allocation methodology chosen, however, the change did not result in any additional cost to the GPO nor did it result in an increase in the price of passports produced for the DOS.

Recommendation

5. The CFO should document and explain the change in indirect overhead allocation methodology from FY 2007 to FY 2008, including an analysis of how and why the new methodology better meets management's needs for accurate cost information.

Management's Response. Concur. The GPO CFO provided an explanation of the Agency's change in the indirect overhead cost rate allocated to passports for FY 2008 and beyond (see Appendix C).

Evaluation of Management's Response. Management's action is responsive to the recommendation. The recommendation will be closed upon issuance of this report.

[8] Net costs are the direct costs of operating the business unit, less pass-through costs of finished goods that are charged to the business unit, but have no value-added by the business unit. These finished goods that pass through without value added include: printing and reproduction, GPO Access charges, blank paper sold to customer agencies, and reimbursable postage.

Other Observations

The following observations were made during the audit and are presented for management's consideration and disposition as necessary.

No Passport Costing Policy

GPO had no formal documented passport costing policy and procedures. Paragraph 71 of SFFAS 4 states:

> Documentation—All managerial cost accounting activities, processes, and procedures should be documented by a manual, handbook, or guidebook of applicable accounting operations. This reference should outline the applicable activities, provide instructions for procedures and practices to be followed, list the cost accounts and subsidiary accounts related to the standard general ledger, and contain examples of forms and other documents used.

GPO Instruction 825.18A, "Internal Control Program," May 28, 1997, section 8.G requires that, ". . . the documentation for transactions, management controls, and other significant events must be clear and readily available for examination." Thus, a formally documented passport costing process would improve internal controls by outlining all key authorities, duties, and responsibilities in authorizing, processing, recording, and reviewing official agency transactions thereby facilitating vulnerability assessments and internal control reviews.

Immaterial Overstatement of Labor Costs

The labor costs for one of 11 cost centers charging labor hours to passports (Cost Code 2000 Office of Security and Intelligent Documents) were overstated. GPO charged all of the labor costs for Cost Code 2000 fully to passports. However, the Managing Director, SID stated that his office does not work 100 percent of the time on passports because the office works on more than just passports.

In addition, of 13 employees in Cost Code 2000 whose time was directly charged to passport costs, 5 of the employees charged more than 8 hours a day, 40 hours a week, but didn't have any corresponding charge for overtime. Through further review we found that those employees worked an alternate work schedule and were paid correctly. However, through oversight, GPO did not properly adjust costing records for passport costing and as a result overstated the amount of labor for those five employees by $5,752 for February 2008.

The CFO should assess the impact of each of these observations with respect to passport pricing and operations and take action as deemed appropriate.

Appendix A. Objectives, Scope, and Methodology

We performed this audit from March through November 2008 at the GPO Central Office in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform our work to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the objectives. We believe that the evidence obtained during this review provides a reasonable basis for our findings and conclusions based on our objectives.

Objectives

The overall audit objective was to assess GPO's basis for establishing the passport production rate that it charges DOS. Specifically, we determined if GPO had an effective passport cost accumulation and allocation methodology in place to support the price charged to DOS for each passport produced, and if the amount of income realized from passport sales was allowable under applicable requirements.

Scope and Methodology

To perform our audit, we analyzed the financial operations of GPO's Security and Intelligent Documents business unit for FY 2008 through May 2008. To accomplish our objectives, we performed the following:

- Reviewed GPO passport production cost accumulation and reporting procedures contained in Title 44, the DOS/GPO MOU, GPO's FY 2007 Annual Report and Financial Statements, GPO's Monthly Financial Packages, and other financial documents.

- Interviewed the following GPO officials: CFO; Controller; Controller, Plant Operations; Controller, Systems; Assistant Controller, Finance and Administration Division; Manager, Financial Systems; Director, Accounting Operations; Chief, Plant Production Rate and Investigation Branch; Chief Supply Management Officer; Managing Director, Security and Intelligent Documents; Chief Acquisition Officer; and Chief Information Officer.

- Reviewed various cost reports provided by the officials interviewed.

- Tested direct costs incurred by the Security and Intelligent Documents business unit for one selected month (February 2008) by tracing the costs reported on the monthly Gross Profit Summary report, to original source documents including material order slips, invoices, and time and attendance reports.

We also reviewed the following Federal costing standards:

- The Cost Accounting Standards (CAS) developed by the Cost Accounting Standards Board to achieve uniformity and consistency in the measurement, assignment, and allocation of costs to Government contracts.

- Statement of Federal Financial Accounting Standards Number 4 (SFFAS 4), "Managerial Cost Accounting Concepts and Standards for the Federal Government," issued on July 31, 1995, by the Federal Accounting Standards Advisory Board.

We compared those standards with the processes GPO used.

Management Controls Reviewed

We reviewed and evaluated the management controls associated with GPO's procedures for accumulating and reporting passport cost data. Specifically, we determined whether GPO had effective policies and procedures in place to ensure that GPO personnel were correctly and accurately recording passport cost data in the Agency's cost accumulation system. In conducting our review of management controls, we followed GAO Internal Control Standards and GPO Instruction 825.18A, "Internal Control Program," May 28, 1997, paragraph 7(a), which states, "The Public Printer has the overall responsibility to ensure that an effective internal control structure is established and maintained by GPO's managers for all programs, functions, and activities." The audit identified that GPO had no formal documented passport costing policy and procedures, which we describe in detail in this report. Implementing the recommendations in this report should improve that management control deficiency.

Computer-Generated Data

We relied on computer-processed data for this audit. We obtained cost reports for the Security and Intelligent Documents business unit that the Controller for Plant Operations generated from the Oracle financial system. To assess the reliability of that data, we reviewed the work of the independent public accounting firm KPMG and performed our own testing.

KPMG audited GPO's Financial Statements for the year ending September 30, 2007. As part of that audit, KPMG evaluated the information systems control environment to assess the effectiveness of the GPO control environment over its financial systems. KPMG reported that that there were significant deficiencies in the design and/or operations of GPO's IT general controls in Entity-Wide Security, Access, System Software, and Service Continuity. KPMG made several recommendations for improvement, to which GPO concurred.

Appendix A

We performed limited testing to validate the reliability and integrity of that data by tracing the costs reported for one month—February 2008—to the original source documents. We found no discrepancies. Based on the work of KPMG as well as on our limited testing, we placed reliance on the adequacy of the data and considered it sufficient for the purposes of our audit objectives.

Appendix B. Acronyms Used in the Report

CAS	Cost Accounting Standards
CFO	Chief Financial Officer
DOS	U.S. Department of State
FY	Fiscal Year
GPO	Government Printing Office
JCP	Joint Committee on Printing
MOU	Memorandum of Understanding
OIG	Office of Inspector General
SFFAS	Statement on Federal Financial Accounting Standards
SPF	Secure Production Facility

Appendix C. Management's Response

2008 DEC

Memorandum

Security and Intelligent Documents

December 5, 2008

From: Stephen LeBlanc, Managing Director, Security and Intelligent Documents

To:
(1) Tony Ogden, Inspector General, Office of the Inspector General
(2) Kevin Carson, Assistant Inspector General for Audits and Inspections, Office of the Inspector General
(3) Karl Allen, Supervisory Auditor, Office of the Inspector General

Subj: Management's Response to the Draft IG Audit dated November 21st 2008 titled GPO's Passport Printing Costs

Thank you for the opportunity to respond to the draft IG Audit dated November 21, 2008 and titled "Audit of GPO's Passport Printing Costs".

The following response is provided for your reference and addresses the four recommendations contained in the section dealing with Finding A: Generation of Excess Cash.

Draft IG Audit Recommendations in Finding A: Generation of Excess Cash

The Managing Director, SID, in conjunction with the CFO, should:

1. Ensure that GPO continues its bi-monthly meetings with the DOS through the Supply/Demand Working Group to negotiate and agree to detailed short-term production and delivery schedules and production ramp-ups.

In accordance with the GPO/DOS Memorandum of Understanding dated December 2007, the GPO worked with DOS to establish defined committees and working groups to formally discuss, debate and document important aspects of the electronic passport program. In February 2008, the first Committee formed was the Executive Steering Committee that immediately created a Supply/Demand and Quality Working Group with the following charter:

The Supply/Demand and Quality Working Group will negotiate and agree to detailed short-term production and delivery schedules and production ramp plans. It is expected that the working group will seek consensus on the product mix and volumes for the passport. Should the committee reach consensus and should recommended mix and volume be within the level requested and committed to by DOS and GPO, respectively, the Working Group shall have the authority to set the schedule. Should consensus not be reached or if the request is outside of the agreed request/committed schedule, the members of the Working Group will forward its recommendations to the Executive Steering Committee for resolution. The Supply/Demand and Quality Working Group will also be the preferred group for resolution of administrative issues such as purchase orders, billing, and payments. The Supply/Demand and Quality Working Group shall be composed of representatives from both DOS and GPO. Each agency will designate a primary decision maker as its lead representative. A DOS representative will normally chair these meetings.

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This Supply/Demand and Quality Working Group has met regularly for the past nine months working to deal with questions of production rates, inventory levels, schedules for finished product shipments, timely receipts of funding through Standard Form-1s (SF-1s) and product quality issues. During this time, the DOS faced significant challenges that have complicated their ability to present accurate and detailed long and short term production requirements, inventory levels and product delivery schedules to the GPO. An inaccurate 2007 Gallop study contracted by DOS to provide U.S. passport demand projections coupled with an unexpected economic turndown and significant personnel turnover in the DOS's Passport Services organization during early 2008 (new faces across the board from upper management positions to operational planners and action officers) caused great uncertainty in 2008 planning.

The Supply/Demand and Quality Working Group remains an important and effective format for key personnel to regularly meet and work through passport issues. There is a new passport demand study that was contracted by DOS in the fall of 2008 (results expected in February 2009) that is expected to reveal both short and long term passport demand in the U.S. Additionally, this Working Group continues to track inventory levels and shipments to maximize secure storage capacities in both GPO and DOS. This group also oversees the product quality and relationship building through conference calls, site visits and outreach between the GPO production and quality personnel and the DOS's Agency personnel who personalize the blank books provided by GPO. Management concurs with the IG's recommendation. The Managing Director of SID will continue to encourage, attend and foster these Working Group meetings and expects more defined production and delivery schedules to be negotiated in the 2QFY09 timeframe.

2. Work with the DOS and establish a time frame for formalizing and finalizing the 5year Capital Plan for Passports.

In March 2008, another important Committee was formed called the Product Planning and Engineering Change Control Committee. This Committee had the following charter:

The Product Planning and Engineering Change Control Committee will review and approve physical and electronic product features, specifications, procurement plans, and product redesign. The Product Planning and Engineering Change Control Committee will review and propose adoption or rejection of proposed changes to the approving executives at each agency for the current passport product; will recommend whether testing and/or certification is required for the change; and will approve schedules and timing for release to production. Product Planning and Engineering Change Control Committee will review and make recommendations for product standards and specifications and methodologies to manage changes to same. Committee recommendations on product standards and specifications will be forwarded to DOS and GPO agency leadership for approval and incorporation as an update to the standards appendix of the MOU. The Product Planning and Engineering Change Control Committee will provide or assign members to participate in GPO procurement selection committees for the next generation product. The Product Planning Committee shall be composed of representatives each from DOS and GPO with the authority to make recommendations and secure approvals from their respective agencies. The lead GPO and DOS representatives will normally co-chair this meeting. The Product Planning Committee will meet monthly. Contractors will not be invited to this meeting without express consent from both DOS and GPO. Typically only contractors on existing contracts may be invited to this meeting and then only to brief proposed engineering changes for their supplied material.

An important Working Group was formed by the Product Planning and Engineering Change Control Committee in June 2008 to specifically define, debate and document a long term capital

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expenditure plan for the electronic passport program. The definition and approval by both GPO and DOS on a five-year capital spending plan is a vital element in the pricing of a passport. This Five Year Capital Spending Working Group met as often as once per week to define the needed capital outlays to support both the current passport configuration and any future DOS specified security upgrades and modifications to the document. The final five-year capital plan was approved by the Five Year Capital Plan Working Group and the Product Planning and Engineering Change Control Committee in the July/August 2008 timeframe. This document shows a 9.8 million dollar capital outlay in FY09 with a total of 80 million dollars over a five year period FY09-FY13. With the exception of the Deputy Assistant Secretary of State for Passport Services, all the members of the Executive Steering Committee (GPO Deputy Public Printer, Managing Director of SID and DOS Passport Program Manger) have approved and signed off on the five-year capital plan.

During a meeting with the Deputy Assistant Secretary of State for Passport Services on November 21, 2008, she stated that she was still studying specific line items on the five-year capital plan that dealt with a new upgraded security feature the DOS is considering for their future electronic passport that requires capital equipment investments. The specific capital equipment outlays are broken out in the five-year plan for this security feature and their associated line items can easily be removed from the plan, delayed in their execution years or left in the plan as recommended by the Product Planning and Engineering Change Control Committee. Additionally and to aid their decision, GPO has provided DOS with financial documents that explain how the passport price would be affected by their decision to retain or remove the new upgraded security feature under consideration. Management concurs with the IG's recommendation. The Managing Director of SID fully expects that the DOS will make a decision regarding the five-year capital plan during the month of January 2008. Following her decision, the FY09 portion of the five-year plan will be initiated (if approved by DOS) and an addendum to the MOU can be signed that defines the new passport pricing schedule in Appendix H and the approved capital expenditure plan in Appendix I.

3. Finalize the proposed addendum to the GPO/DOS Memorandum of Understanding.

The GPO proposed an addendum to the MOU with DOS during the summer of 2008 that would allow for more frequent pricing reviews, an ability to utilize tiered pricing models and to perform structured financial analysis and end of year "true-ups" to manage over or under recoveries of costs. The proposed addendum is stated below for reference:

Pricing and Cost Review

The GPO will perform a semi-annual pricing review each April and September to ensure that the Passport Pricing reflects the then current costs and demand expectations. The GPO will notify the United States Department of State by letter no later then April 30th and September 30th of each year of any price change requirements, if necessary, which will be effective on the first day of the months of June and December respectively.
All pricing will reflect a multi-tiered approach. The first tier of pricing will be designed to recover all fixed, variable and other costs (inclusive of passport capital requirements, a per book contribution to new investment in the GPO and the estimated proportionate share of overhead costs for the GPO) over a set number of passports produced. Subsequent tiers of pricing will be designed to recover variable costs, any unexpected costs and pricing adjustments as circumstances might warrant at the time. A per book contribution to new investment in the GPO will also be factored into the subsequent pricing tiers. It is expected that the pricing for the second and subsequent pricing tiers will be less than the first pricing tier.

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End of Fiscal Year Analysis

Each September the GPO will analyze all passport related costs incurred and payments received during the fiscal year. In addition, an estimate of the expected passport costs and payments to be received through September 30th will be developed. A determination will be made if the GPO has over/under recovered its costs.
Under-recovered and over-recovered costs will be considered on a prospective basis and will be included in the pricing to be effective December 1 of each year. Over-recovered costs will be treated as a retroactive price decrease and the cash received for the over-recovered cost will be deemed an advanced payment of future passports by the United States Department of State. The GPO and the United States Department of State will coordinate to determine the best method of drawing down the advanced payment of passports through passport production. Likewise, in the event that GPO has under-recovered costs the shortfall will be treated as a retroactive price increase and the cash deficit for the under-recovered cost will be deemed a payable due to the GPO by the United States Department of State. The GPO will include any cost under-recovery as part of the pricing to be effective December 1 of each year. The GPO will provide an analysis to the United States Department of State supporting these actions no later then September 30th of each year.

In September 2008, the GPO received a response to the above suggested addendum from DOS which did not allow a FY08 resolution to the need for processes that will reduce over and under recoveries of costs in the production of passports. These issues are still being discussed directly with the Deputy Assistant Secretary of State for Passport Services in a meeting that took place as recently as November 21st 2008. Management concurs with the IG's recommendation. The Managing Director of SID will facilitate the future discussions between our organizations' financial and legal experts to define processes agreeable to both parties (DOS and GPO) and work to moderate an addendum that satisfies the requirements of both organizations.

4. Update the passport pricing structure taking into account the formal Capital Plan for Passports, the revised indirect cost allocation rate, depreciation of the SPF, and current production estimates. Keep the pricing structure in the same format as the current costing structure.

A meeting was held with the DOS's Deputy Assistant Secretary of State for Passport Services on November 21st to present the current passport pricing. The passport prices were dependent on annual volumes and incorporated the latest five year capital spend plan for FY09, the depreciation of the SPF capital investments and current production rates and estimates. Pricing was also presented (as requested by DOS) with specific line items (optional new upgraded security feature) removed from the five-year capital spend plan. Management concurs with the IG's recommendation. The Managing Director of SID will work with the SID Comptroller and the GPO's Chief Financial Officer to present the passport pricing documents in accurate, readable and descriptive formats that are in keeping with our current costing structure.

Sincerely

Stephen LeBlanc
Managing Director, SID

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Appendix C

2008 DEC -3 PM 2:01

OFFICE OF THE
INSPECTOR GENERAL

UNITED STATES GOVERNMENT PRINTING OFFICE

memorandum

DATE: December 4, 2008

REPLY TO ATTN OF: Chief Financial Officer

SUBJECT: Audit of GPO's Passport Printing Costs

TO: Inspector General
Attn: Mr. Kevin Carson

The attached response is provided relating to Finding B. Change in Indirect Overhead Allocation Rate as included in your Draft Audit of GPO's Passport Printing Costs.

I appreciate the opportunity to comment on the draft report.

Steven T. Shedd

Steven T. Shedd
Chief Financial Officer

Finding B Change in Indirect Overhead Allocation Rate.

Recommendation: The CFO should document and explain the change in indirect overhead allocation methodology from FY2007 to FY2008, including an analysis of how and why the new methodology better meets management's needs for accurate cost information.

Response to Finding B Change in Indirect Overhead Allocation Rate.

The growth and uncertainty of passport demand has created many issues relating to passport pricing and the allocation of overhead costs.

Before the start of every year the finance department prepares a schedule that spreads the GPO's budgeted overhead expense across its eight business units using a standardized methodology (see Table 2) to attempt to achieve a balance. Achieving a balance means that the allocation goal for each business unit is for each unit to be able to pay for the overhead allocated to them, allowing the business unit and the GPO in total to be slightly positive or breakeven. If the GPO cannot achieve this overall goal, then it is possible that the GPO could be in danger of violating Title 44 (not recovering all costs) or in a more extreme case violating the Anti-Deficiency law (obligating more funds than you have authorization or the ability to pay). For most years, the same methodology as used in prior years is sufficient because the fundamentals of the business have tended to remain the same. However, with the onset of the electronic passport in Fiscal Year 2007 the dynamics changed drastically. Table 1 below identifies the dramatic shift in the GPO's business caused by the electronic passport between FY2005 and FY2008.

Table 1

	FY05	FY06	FY07	FY08
Passport Revenue	25,183,846	43,739,000	241,490,000	298,504,000
Passports as a % of GPO Business	9.09%	14.12%	47.70%	53.00%
% of Total Overhead Applied to Passports	6.57%	3.95%	5.91%	48.45%
Passports Produced	10,222,999	13,661,000	20,606,000	24,015,400

Appendix C

Table 2

OH Allocation Methods	FY05	FY06	FY07	FY08
Administrative Services	**Employees**	**Employees**	**Employees**	**Net Cost**
Building Expense	**Space**	**Space**	**Space**	**Space**
Administrative Support	**Employees**	**Employees**	**Employees**	**Net Cost**
Procurement Support	**Employees**	**Employees**	**Employees**	**Employees**
Engineering Charges	**Jobs**	**Space**	**Space**	**Space**

As can be seen in Table 1, Passports have grown from roughly 9% of the GPO's business in FY05 to 53% of the GPO's business in FY08. Yet though Passports represented 9% of the GPO's business in FY05, the allocation method used (see Table 2 above) charged only 6.57% of the overhead to Passports. As Passport volume grew and the allocation method used remained the same, the imbalance continued to grow. Passport revenue in FY06 was 14.12% of the business, yet only 3.95% of the overhead was charged to passports. When volume really took off in FY07, the difference became too great to not make a change. In FY07, passports represented 47.7% of the business and received only 5.91% of the overhead. It is important to note that the allocation algorithm is part of the GPO's operating budget and is prepared a year in advance, so if the business changes rapidly and unexpectedly, imbalances will occur. In FY07 (and in FY08), passport demand was greater than expected, the GPO had no definitive demand projections from DOS which made pricing and the allocation of overhead to the number of books planned to be produced very difficult to determine. In FY08, we decided to close this imbalance between the GPO's business units and determine a new method of allocating overhead that would be more representative of reality and would not endanger the GPO into a possible violation of Title 44. As indicated in the audit report (and in Table 2 above), the GPO chose the net cost method of allocating Administrative Services and Support which, in FY2008, resulted in 48.45% of the overhead being charged to Passports which now represented 53% of the business. This represents a more accurate allocation of overhead to Passports and the GPO's other business units.

Appendix D. Status of Recommendations

Recommendation No.	Resolved	Unresolved	Open/ECD*	Closed
1	X			X
2	X		January 2009	
3	X		March 2009	
4	X		March 2009	
5	X			X

*Estimated Completion Date.

Appendix E. Report Distribution

Government Printing Office

Public Printer
Deputy Public Printer
Chief Human Capital Officer
Chief Information Officer
Chief Technology Officer
Director, Congressional Relations
Managing Director, Plant Operations

Major Contributors to the Report

Karl Allen, Supervisory Auditor