June 30, 2004

DENNIS R. UNGER
MANAGER, TENNESSEE DISTRICT

SUBJECT: Audit Report – Self-Service Vending Program – Tennessee District
(Report Number DR-AR-04-003)

This is one of a series of audit reports on the Self-Service Vending Program in the Southeast Area. The report presents the results of our self-initiated audit on the Self-Service Vending Program in the Tennessee District (Project Number 04WG003DR002). The information in this district report will be included in a report to the Southeast Area Vice President.

Background

The Self-Service Vending Program, implemented in October 1964, is one of the Postal Service's major programs. It provides Postal Service customers with a convenient alternative for purchasing stamps and other basic Postal Service products after business hours and without the need to stand in line during business hours. Nationwide, the Postal Service maintains approximately 30,000 vending machines (27,000 self-service postal centers and 3,000 other types of vending equipment) that generated over $1.9 billion in revenue during fiscal years (FYs) 2001 through 2003. The Southeast Area had 4,298 pieces of vending equipment that generated over $109 million in revenue during FY 2003, of which the Tennessee District maintained 812 (19 percent of the total area) machines that generated over $14.8 million (14 percent of the total area) in revenue in the same year.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the Self-Service Vending Program is effectively and efficiently meeting program goals of increasing revenue and reducing operating costs. Specifically, in this review, we determined whether Self-Service Vending Program managers have effectively redeployed vending equipment that does not meet minimum revenue requirements in order to maximize revenue, and discontinued the use of obsolete vending equipment. Of the 812 vending machines operating in the Tennessee District, 96 were classified as obsolete based on Postal

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Service guidance, while the remaining 716 were classified as current equipment. During our audit work, we visited Postal Service facilities, interviewed managers and employees, reviewed documentation and applicable policies and procedures, and analyzed data in the Postal Service's Vending Equipment Sales and Service System for FYs 2002 through 2003 to identify obsolete equipment and equipment that did not meet the minimum revenue requirements.[1] Although we relied on data obtained from the Vending Equipment Sales and Service System, we did not test the validity of the data and controls over the system. Audit work associated with the Tennessee District was conducted from December 2003 through June 2004, in accordance with generally accepted government auditing standards and included such tests of internal controls as were considered necessary under the circumstances. We discussed our observations and conclusions with appropriate management officials and included their comments, where appropriate.

Prior Audit Coverage

We did not identify any prior audits or reviews related to the objective of this review.

Audit Results

Opportunities exist for Tennessee District officials to improve the effectiveness and efficiency of the Self-Service Vending Program and to meet or exceed program goals of increasing revenue and reducing operating costs. Specifically, officials could increase revenue opportunities by redeploying equipment that does not meet minimum revenue requirements. Further, Tennessee District officials could reduce maintenance and repair costs by discontinuing the use of obsolete equipment.

Redeployment of Vending Equipment

Tennessee District officials could improve their process for redeploying vending equipment that does not meet Postal Service minimum revenue requirements. Specifically, in FY 2003, the Tennessee District may have missed revenue opportunities totaling approximately $1.1 to $3.5 million by not redeploying vending equipment that does not meet the Postal Service's minimum revenue requirements.[2] Our review of vending equipment revenue reports showed that 416 (58 percent) of the 716 vending machines did not meet minimum revenue requirements during FY 2003, and district officials did not initiate any redeployment actions. Average vending equipment sales

[1] Obsolete equipment was not included in the minimum revenue analysis.
[2] For each vending machine, we calculated the shortfall in revenue compared to the established minimum for a particular machine type and referred to this shortfall as "missed revenue opportunities." The $1.1 million represents the minimum total possible missed revenue opportunities after giving consideration to Postal Service guidance, which requires district officials to review revenue reports and take appropriate actions if a vending machine's revenue does not reach plan in three to six accounting periods. The $3.5 million represents the maximum total possible missed revenue opportunities for the FY 2003 and is calculated by subtracting actual revenues generated from the total of all machine minimum revenue requirements.

totaled approximately $3.6 million, which was significantly less than the average minimum revenue requirement of $7.1 million.

One of the Self-Service Vending Program's goals is to increase revenue through redeploying equipment. The Postal Service should redeploy equipment that does not meet minimum revenue requirements to other locations. Postal Service policy, Handbook PO-102, Self Service Vending Operational and Marketing Program, May 1999 (updated with Postal Bulletin revisions through December 25, 2003), establishes the minimum revenue requirements for vending machines. The District Retail Office is responsible for evaluating equipment revenue to find the right location for the right machine. If self-service vending equipment is located in an area where it is unable to generate revenue to meet the minimum requirement, the equipment must be considered for redeployment. If revenue does not meet the minimum requirement in three to six accounting periods, the District Retail Office should place the equipment on a list for redeployment; notify any office where changes will be made; prepare a typewritten or computer-generated notice, approved through the District Retail Office, to be posted in the lobby informing customers 30 days before removing the equipment; and complete Postal Service Form 4805, Maintenance Work Order, and move the equipment to a better location.

District officials did not initiate any redeployment action for the 416 under performing machines because they did not review vending equipment revenue reports to identify under performing equipment, nor did they issue low-revenue letters to notify postmasters. District officials indicated that the Self-Service Vending Program was not considered high-priority, and limited resources were allocated to the program. Work efforts were directed to higher priorities such as retail postage revenue. By not taking action to redeploy under performing equipment, the district could miss revenue opportunities during FY 2004.

We discussed the results with Tennessee District officials and they agreed that they could improve their redeployment process for equipment that does not meet the Postal Service's minimum revenue requirements.

Recommendation

We recommend the Manager, Tennessee District, direct the Retail Manager to:

1. Review revenue reports to identify under performing equipment; notify postmasters of equipment that generates low revenue; give consideration to all feasible alternatives; and complete all necessary actions to redeploy under performing equipment as often as possible.

Management's Comments

The Tennessee District agreed that opportunities exist to improve the effectiveness and efficiency of the Self Service Vending Program. In January 2004, the retail staff created and implemented the Tennessee District Vending Management Plan. The Retail Manager and Specialists identified under-performing equipment on May 12, 2004. The Tennessee District realizes the importance of strategically placing vending equipment to meet customer needs. Tennessee district officials plan to make every effort to place the correct machine at the correct location during the period of July 30 through September 30, 2004. Consideration will be given to feasible alternatives before removing or relocating any vending equipment. Management's comments, in their entirety, are included in the appendix of this report.

Evaluation of Management's Comments

Management comments are responsive to our recommendation. Management's actions taken or planned should correct the issues identified in the finding.

Use of Obsolete Equipment

During FY 2003, Tennessee District officials continued to use and incur maintenance and repair expenses for 96 obsolete machines, although Postal Service policy discontinued maintenance and repair support for the machines in June 2000.[3] Vending equipment revenue reports showed that 82 (85 percent) of the 96 machines did not meet minimum revenue requirements during FY 2003. District officials stated that they continued to use the obsolete equipment because postmasters and their managers of Post Office Operations would not remove obsolete equipment because of the potential adverse impact on customer service since replacement equipment was not available. As a result, the Tennessee District incurred maintenance and repair expenses during FY 2003, by continuing to operate and maintain the 96 obsolete machines. We were unable to determine the amount of repair and maintenance expenses associated with the 96 machines because the Postal Service does not capture the data for each machine.[4]

Periodically, the Postal Service lists vending equipment as obsolete, meaning that the equipment has exceeded its expected life cycle and will no longer receive support from maintenance organizations. Inactive retail vending equipment items must be reported to the District Material Management Specialist. When retail vending equipment items are obsolete or listed as excess, the Postal Service may consider them for disposal action. Parts from obsolete machines may be salvaged and stored for maintenance and

[3] This Maintenance Management Order (MMO) supplements MMO-018-96, dated June 21, 1996, titled - Discontinuance of Support for Obsolete Vending Machines. This MMO includes discontinuance of support for recently obsolete models of vending machines announced in the Material Logistics Bulletin (MLB-PP-00-004), issued on May 18, 2000.
[4] We plan to conduct a future audit on vending equipment maintenance and repair costs.

repair of other compatible equipment. In June 2000, Postal Service policy listed the obsolete vending equipment that should no longer receive support from maintenance organizations.

By continuing to use and maintain obsolete machines, the district may incur repair and maintenance cost that exceed the revenue generated. We recognize management's desire to provide customer service; however, because repair and maintenance costs are not captured, management has no means of assessing whether the benefits of operating the obsolete equipment outweigh the costs to operate it. We are making no recommendations to the district regarding this finding. However, we plan to make a recommendation to Postal Service Headquarters to address the policy of discontinuing maintenance and repair support for obsolete equipment.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Debra D. Pettitt, Director, Delivery and Retail, at (404) 507-8329 or me at (703) 248-2300.

/s/ Mary Demory

Mary Demory
Deputy Assistant Inspector General
for Operations and Human Capital

cc: William J. Brown
Larry Lee
Melodie Ransom
Joseph K. Moore

APPENDIX. MANAGEMENT'S COMMENTS

DISTRICT MANAGER, CUSTOMER SERVICE AND SALES
TENNESSEE DISTRICT

UNITED STATES
POSTAL SERVICE

June 10, 2004

KIM H. STROUD
DIRECTOR, AUDIT OPERATIONS
OFFICE OF INSPECTOR GENERAL

SUBJECT: Draft Audit Report – Self-Service Vending Program – TN District
(Report Number DR-AR-04-DRAFT)

Please find attached the response to the draft audit report concerning the "Self-Service Vending Program" for the Tennessee District. A copy of the updated "Tennessee District Vending Management Plan" is included also.

We appreciate the recommendations for improving our vending program, as well as, the shared challenges our staffs have jointly identified.

If you have any questions or concerns regarding this response, please contact Melodie Ransom, Manager, Retail at 615-872-5772.

ACTING
D.R. Unger

cc: William Brown
Linda Jacobson
Larry E. Lee
Melodie K. Ransom

Attachments

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May 10, 2004
Draft Audit Report - Self-Service Vending Program - Tennessee District

AUDIT RESULTS
Opportunities exist for the Tennessee District officials to improve the effectiveness and efficiency of the Self-Service Vending Program and to meet or exceed program goals of increasing revenue and reducing operating costs. Specifically, officials could increase revenue opportunities by redeploying equipment that does not meet minimum revenue requirements. Further, Tennessee District officials could reduce maintenance and repair costs by discontinuing the use of obsolete equipment.

REDEPLOYMENT OF VENDING EQUIPMENT (Ref. pg. 2, Audit Report)

DISTRICT RESPONSE
In January 2004, the retail staff created and implemented the Tennessee District Vending Management Plan. The retail specialists identified the under performing equipment. Of the four hundred and sixteen (416) under performing machines identified by the OIG, only two hundred and thirty (230) machines do not meet ½ of the required monthly sales. The Vending Equipment Sales and Service (VESS) database does not target a machine for removal or redeployment until that machine's average monthly revenue falls below one-half of the minimum monthly requirements. One hundred and fifty three (153) machines of the 416 referred to in the Audit Report are meeting one-half (1/2) of the sales requirements. It is our contention that these machines should not be considered for removal. (See comments) In addition, fifty-eight (58) machines not meeting minimum requirements are targeted by VESS to be removed and replaced with a different model requiring less monthly revenue. The Tennessee District realizes the importance of strategically placing vending equipment to meet customer needs. Every effort will be made to place the correct machine at the correct location. We would like to consider all feasible alternatives before removing or relocating any vending equipment. Criteria for the removal of any vending needs to be clear and uniform. We will take into consideration the impact any removal may have on WTIL (Waiting Time in Line) and customer satisfaction.

CLARIFICATION/CORRECTION
The Tennessee District vending goal for FY '04 is $14,768,793; 5.06% of the entire retail '04 Retail Revenue Plan of $296,421,605. Conversely Line 3 is over 82% of the Plan or $244,421,605 comprised of domestic and international expedited shipping and package revenue, and all Special Services revenue (and, postage revenue as stated in the report). In FY '02, 50% of the retail staff (two of the four retail employees) for the entire district were detailed, and the manager was newly assigned mid year of FY '02. In FY '03 all three retail specialists were newly assigned. Vending is one of 38 retail programs/projects. Further, as discussed during interviews with the auditors, Tennessee District due to its geographical size (state of Tennessee and northern part of Georgia), and number of retail offices (641), retail specialists are domiciled through out the district and responsible for every retail program/project. (In almost all other districts they are assigned by programs/projects; one retail specialist has Line 6

items in which vending is one of the three main Line items along with the respective projects, for example.) Ergo, staff was focused by the 80/20 rule to assist the district that was not attaining retail revenue and mystery shopper goals in FY '02 at mid year, and continued to struggle in FY '03 due to the recession and a new, undeveloped staff.

USE OF OBSOLETE EQUIPMENT (Ref. pg. 4, Audit Report)
There are ninety-six (96) pieces of obsolete equipment operating in the Tennessee District.

DISTRICT RESPONSE
The Retail Specialists analyzed data from VESS by reviewing the "Equipment Relocation Analysis Report." Current VESS reports now indicate fifty-one (51) pieces of obsolete equipment in the field. A bill acceptor was installed on twenty-three (23) PS-53Cs making them a PS-53C Modified. A bill acceptor was installed on twenty-one (21) PBM-2s making them a PBM-2A. One (1) PS-53 had the modification kit installed making it a PS-53C Modified. Retail completed the update to VESS May 2004.

According to the "Active/Remove Machines by Model" and the "Machine Sales By Location Type" reports from VESS, obsolete equipment generated $371,734.18 in FY 2003 and $237,137.35 in FY 2004 ytd. There are enough current inventories to replace twenty (20) PS-53Cs with a PS-53D. Retail will review the remaining thirty-one (31) pieces of obsolete equipment deployed in the field. If it is determined that the removal will have a negative impact on customer service, we will seek other options. In the future, any machines designated as obsolete will be removed or replaced.

Retail has reviewed reports from electronic Maintenance Activity Report Scheduling (eMARS) provided by West Tennessee Maintenance. A sampling was taken of 11 offices with obsolete equipment.This sampling indicates maintenance costs for labor and materials on obsolete equipment is minimal compared to the revenue the obsolete vending equipment generates. The Tennessee District agrees that the obsolete equipment should be replaced as soon as possible. However, we are concerned about the negative impact the removal may have on our customers and replacement equipment is not available since no new vending has been available for almost eight years.

COMMENTS:
Pat Poff, Retail Specialist, contacted Gloria Spencer, OIG, SE Area Project Manager for Delivery and Retail, and Victoria Dixon, OIG Auditor and Site Leader for the Tennessee District Project to confirm the criteria used for this audit. Ms. Spencer stated that the PO 102 Handbook (Self Service Vending Operational and Marketing Program) was the criteria used by the OIG. The VESS database does not target for removal or redeployment any machine meeting one-half (1/2) of the required monthly sales, conflicting with the PO 102. The PO 102 does not

make any provisions for machines meeting one-half of the required monthly sales. Ms. Spencer and Ms. Dixon agree that the VESS database and the P.O. 102 criteria should be the same. The Tennessee District requests the OIG to address this conflicting criteria. Using the VESS database report as the criteria for removal or redeployment would protect the vending at smaller offices, providing customer service at all 641 post offices in the Tennessee District.

TENNESSEE DISTRICT VENDING MANAGEMENT PLAN (See Attached)
This Plan addresses the OIG concerns and recommendations. It is our goal to increase revenue by strategically deploying all vending equipment. It is also our goal to track and minimize costs associated with this equipment especially regarding obsolete equipment.

OIG RECOMMENDATION
1. Review revenue reports to identify under performing equipment; notify postmasters of equipment that generates low revenue; give consideration to all feasible alternatives; and complete all necessary actions to redeploy under performing equipment as often as possible.

DISTRICT ACTION
The Retail Manager and Retail Specialists jointly verified the "Relocation and Equipment Analysis Report" from VESS on May 12, 2004. Offices with under performing equipment were identified (as outlined above.)

Retail Specialists will send Initial Low Revenue Letters (see attached) to all offices with under performing equipment. The Retail Specialists will use the VESS report "Relocation Equipment Analysis Report" as a tool for any removal and redeployment. Consideration to WTIL (Wait Time in Line) issues and customer service and satisfaction will be addressed before any action. The Tennesssee District recognizes that some post offices have one vending machine and removal may have a negative impact in the community and on customer service affecting revenue.

SOP FOR REDEPLOMENT
1. Identify under performing equipment*.
2. Review for 3 to 6 months.
3. Place the equipment on a list for redeployment
4. Notify the office where changes will be made. Send an Initial Low Revenue Letter
5. In 60 days send a Redeployment Letter to postmaster/manager
6. Send a letter approved through the District Retail Office to be posted in the lobby informing customers 30 days before removing the equipment
7. Target optional site for the equipment
8. Complete 4805, maintenance Work Order, and move the equipment to a better location.

9. Insure all capital property numbers are recorded and sent to designated person
10. Change all information in VESS to reflect removal or relocation

*Under performing equipment is identified as any vending machine not meeting an average of ½ of the required monthly sales. Review and follow recommendations from the VESS report "Relocation Equipment Analysis Report."