September 24, 2004

LAWRENCE K. JAMES
MANAGER, RIO GRANDE DISTRICT

SUBJECT: Audit Report – Self-Service Vending Program – Rio Grande District (Report Number DR-AR-04-010)

This is one of a series of audit reports on the Self-Service Vending Program in the Southwest Area. The report presents the results of our self-initiated audit on the Self-Service Vending Program in the Rio Grande District (Project Number 04YG024DR001). The information in this district report will be included in a report to the Southwest 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 (FY) 2001 through 2003. During FY 2003, the Southwest Area had 3,876 pieces of vending equipment that generated over $87 million in revenue, of which the Rio Grande District maintained 21 percent (823) of the total area machines that generated 21 percent ($18 million) of the total area vending revenue. During the first quarter of FY 2004, the Southwest Area had 3,989 pieces[1] of vending equipment that generated over $23 million in revenue, of which the Rio Grande District maintained 21 percent (836[2]) of the total area machines that generated 22 percent ($5 million) of the total area vending revenue.

[1]The Southwest Area had 113 additional vending machines during the first quarter of FY 2004.
[2]The Rio Grande District had 13 additional vending machines during the first quarter of FY 2004.

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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. We also physically observed a judgmental sample of 20 vending machines to determine whether the machines were operational and easily accessible. For the 823 vending machines operating in the Rio Grande District during FY 2003, 121[3] were classified as obsolete based on Postal Service guidance, while the remaining 702 were classified as current equipment. For the first quarter of FY 2004, 836 vending machines were operating in the Rio Grande District, of which 126[4] were classified as obsolete, and the remaining 710 were classified as current equipment.

During our audit, 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 (VESS) for FY 2003 and the first quarter of FY 2004 to identify obsolete equipment and equipment that did not meet the minimum revenue requirements.[5] Although we relied on data obtained from VESS, we did not test the validity of the data and controls over the system.

Audit work associated with the Rio Grande District was conducted from July through September 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

The Office of Inspector General (OIG) has issued three reports related to the objective of this audit.

Self-Service Vending Program - Tennessee District (Report Number DR-AR-04-003, June 30, 2004), Self-Service Vending Program - Alabama District (Report Number DR-AR-04-004, June 30, 2004), and Self-Service Vending Program - Atlanta District (Report Number DR-AR-04-002, July 1, 2004). The reports stated that district officials could improve their process for redeploying vending equipment that does not meet minimum revenue requirements. In FY 2003, 54 percent (857 of 1,573) of the vending

[3] This number includes three currency changer machines, which do not generate revenue.
[4] This number includes three currency changer machines, which do not generate revenue.
[5] Obsolete equipment was not included in the minimum revenue analysis.

machines in the Tennessee, Alabama, and Atlanta, Districts did not meet the minimum revenue requirements and the districts may have missed revenue opportunities of approximately $2.7 to $8.5 million by not redeploying this equipment. Additionally, these districts continued to use 250 obsolete machines and possibly incurred maintenance and repair expenses. Management agreed with all recommendations and the actions taken and planned were responsive to the recommendations.

Audit Results

Opportunities exist for Rio Grande 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, Rio Grande District officials could increase revenue opportunities by redeploying equipment that does not meet minimum revenue requirements. Further, Rio Grande District officials could possibly reduce maintenance and repair costs by discontinuing the use of obsolete equipment. Additionally, while our physical observation of vending machines in the Rio Grande District indicated that overall the machines were easily accessible, the machines were not always operable.

Redeployment of Vending Machines

Rio Grande District officials could improve their process for redeploying vending equipment that does not meet Postal Service's minimum revenue requirements. Specifically, during FY 2003, our review of the vending equipment revenue reports indicated that 62 percent (433 of 702) did not meet the minimum revenue requirements. Vending equipment sales were approximately $4 million, which was significantly less than the minimum revenue requirement of $8.1 million. As a result, the Rio Grande District may have missed revenue opportunities of approximately $1.2 million to $4.1 million by not redeploying this equipment.[6]

Additionally, during the first quarter of FY 2004, our review of the vending equipment revenue reports indicated that 58 percent (414 of 710) did not meet the minimum revenue requirements. Vending equipment sales were approximately $840,000, which was significantly less than the minimum revenue requirement of $1.675 million. As a result, the Rio Grande District may have missed revenue opportunities of approximately $835,000 by not redeploying this equipment.

[6] 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 $1.2 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 $4.1 million represents the maximum total possible missed revenue opportunities for FY 2003 and is calculated by subtracting actual revenues generated from the total of all machine minimum revenue requirements.

One of the Self-Service Vending Program's goals is to increase revenue through the redeployment of 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, Chapter 2, Section 256, 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 enough 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 (PS) Form 4805, Maintenance Work Order, and move the equipment to a better location.

District officials did not initiate redeployment action for the underperforming vending machines during FY 2003 and the first quarter of FY 2004 because the Self-Service Vending Program was not considered a high priority. Work efforts were directed to higher priorities such as deploying automated postal centers.[7] Further, the district had only two retail specialists and their efforts were focused on managing other retail programs such as the contract postal units and the Mystery Shopper program. Additionally, district officials were concerned about the potential adverse impact to customer service if the machines were moved. Previous attempts to redeploy underperforming equipment were met with resistance from postmasters because the nonavailability of vending equipment in their facilities would impact customer service. However, by not taking action to redeploy underperforming equipment, the district could miss revenue opportunities during the remainder of FY 2004.

District officials expressed that they did not have any concerns with the Postal Service's criteria and methodology used to establish minimum revenue requirements. However, district officials did express that the criteria does not take into account the challenges, resources, and coordination efforts required to redeploy vending equipment. We plan to forward the district's concerns to Postal Service Headquarters.

We discussed the results with Rio Grande 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. District officials indicated that plans are being made to reassess vending locations based on an analysis of vending operations and receipt of 53 automated postal centers.

[7] Automated postal centers are a newly developed kiosk that provides convenient 24-hour automated access to purchase stamps as well as many premium delivery services such as Express and Priority Mail.

Recommendation

We recommend the Manager, Rio Grande District, direct the Retail Manager to:

1. Review revenue reports to identify underperforming equipment; notify postmasters of vending equipment that generates low revenue; and giving consideration to all feasible alternatives, complete all necessary actions to redeploy underperforming equipment as often as possible.

Management's Comments

Management agreed with our finding and recommendation. The District Manager stated the retail manager has initiated the process of reviewing the VESS Report and has identified vending equipment that is not meeting the minimum required revenue. Postmasters have been notified in writing that underperforming vending equipment is being removed and an evaluation has been conducted to deploy the equipment to another location. Management stated their review actions will be an ongoing process; however, the initial 25 vending machines identified for removal, redeployment, or destruction will be completed by quarter 2, FY 2005.

Evaluation of Management's Comments

Management's actions taken or planned are responsive to the recommendation and should resolve the issue identified in this finding.

Use of Obsolete Equipment

In FY 2003, Rio Grande District officials continued to use 118[8] obsolete machines and possibly incurred maintenance and repair expenses, although Postal Service policy discontinued the maintenance and repair support for the machines in 2000.[9] Our review of vending equipment revenue reports showed 92 percent (109 of 118) did not meet minimum revenue requirements. Additionally, during the first quarter of FY 2004, our review of vending equipment revenue reports indicated that 86 percent (106 of 123) of the machines did not meet minimum revenue requirements.

District officials stated that they continued to use and maintain the obsolete equipment because removing the equipment would not be cost effective and because of concerns regarding the potential adverse impact on customer service. As a result, during FY 2003 and the first quarter of FY 2004, the district possibly incurred maintenance and repair expenses that may have exceeded the revenue generated by continuing to operate and maintain the obsolete machines. We were unable to determine the amount

[8] This number excludes three currency changer machines, which do not generate revenue.
[9] This Maintenance Management Order (MMO) supplements MMO-018-96, June 21, 1996, 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.

of repair and maintenance expenses associated with the machines because the Postal Service does not capture the data for each machine.[10]

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. All 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 or 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 will possibly incur repair and maintenance costs that may exceed the revenue generated. We recognize management's desire to provide customer service; however, because the Postal Service does not capture repair and maintenance, management has no means of assessing whether the benefits of operating the obsolete equipment outweigh the costs to operate it. District officials indicated that plans will be made to replace the obsolete machines when new automated postal centers are deployed to the district locations.

Recommendation

We recommend the Manager, Rio Grande District, direct the Retail Manager to:

2. Consider all feasible alternatives, and complete all necessary actions to eliminate repair and maintenance cost for the obsolete equipment.

Management's Comments

Management agreed with our finding and recommendation. The retail manager will utilize VESS to identify locations with obsolete vending equipment and initiate actions to remove equipment that is underperforming. Obsolete equipment identified as needing repair will be removed or destroyed. Management initiated action and will continue this process on an ongoing basis.

Evaluation of Management's Comments

Management's actions taken or planned are responsive to our recommendation and should resolve the issue identified in this finding.

[10] We plan to address this issue in a capping report to Postal Service Headquarters officials.

<u>Physical Observation of Vending Equipment</u>

Our physical observation of vending machines in the Rio Grande District indicated that overall the machines were easily accessible, but not always operable. Specifically, 10 percent (2 of 20) of the machines judgmentally selected for review were not operating properly in July 2004. One machine was vandalized and could not be repaired. District officials provided a work order to remove this machine and replace it with another vending machine. The second machine was broken, but did not have a sign informing customers that it was out of order. District officials stated this machine would be removed by August 8, 2004. We reviewed the VESS and verified the district removed the machine.

VESS is a nationwide computerized reporting system for the Self-Service Vending Program, which is used as a management tool for real-time tracking of vending cost in relation to sales. Data maintained in the VESS database is generated from PS Form 8130, Vending Equipment Sales and Service Daily Activity Log.[11] Each employee associated with self-service vending equipment must complete a PS Form 8130 detailing the equipment serviced and maintained during each month.

Based on management's actions to remove the inoperable machines, we offer no recommendations.

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

/s/ Mary W. Demory

Mary W. Demory
Deputy Assistant Inspector General
for Operations and Human Capital

Attachment

cc: John A. Rapp
Kenneth W. Britton
Mary Barcenez
Pamela S. Gleason
Steven R. Phelps

[11] We plan to conduct an audit on the accuracy of data in VESS.

APPENDIX. MANAGEMENT'S COMMENTS

DISTRICT MANAGER, CUSTOMER SERVICE & SALES
RIO GRANDE DISTRICT

UNITED STATES
POSTAL SERVICE

September 8, 2004

Kim H. Stroud
Director, Audit Operations
1735 N Lynn St.
Arlington, VA 22209-2020

Dear Ms. Stroud:

Attached is the response to your letter of August 26, 2004, concerning the Rio Grande District Self-Service Vending Program audit findings.

After review of the response provided by the Rio Grande Manager, Marketing, I agree with the actions taken to correct the findings.

If you need additional information, please feel free to call.

Sincerely,

Lawrence K. James

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MANAGER, MARKETING
RIO GRANDE DISTRICT

UNITED STATES
POSTAL SERVICE

September 8, 2004

Lawrence K. James
District Manager

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

In accordance with the memorandum from the Office of Inspector General dated August 26, 2004 listed below is our response.

Recommendation: (Management agrees with finding)

1) Retail Manager should be directed to review revenue reports to identify under performing equipment, notify postmasters of vending equipment that generates low revenue; and giving consideration to all feasible alternatives, complete all necessary actions to deploy underperforming equipment as often as possible.

Response:

Retail Manager has initiated the process of reviewing the Vending Equipment Service System (VESS) Report and has identified vending equipment that is not meeing the minimum required revenue. Postmasters have been notified in writing that the underperforming vending equipment is being removed. Workorders have been issued to remove this vending equipment and an evaluation has been conducted to deploy the equipment to another location. Under performing equipment targeted for removal which is obsolete has been tagged for destruction. This will be an ongoing process; however, the initial 25 vending machines identified for removal, redeployment or destruction will be completed by Quarter 2, FY 05.

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Recommendation: (Management agrees with finding)

2. Retail Manager should be directed to consider all feasible alternatives, and complete all necessary actions to eliminate repair and maintenance cost for the obsolete equipment.

Response:

Retail Manager will utilize VESS Report to identify locations with obsolete vending equipment and initiate actions to remove equipment that is underperforming. In locations where this equipment is generating the required minimum revenue the equipment will remain while it is in operable condition. Obsolete vending equipment identified as needing repair will be removed and destroyed. Action has been initiated and will continue on an ongoing basis.

If you have questions or need additional information, please let me know.

Ken Britton

Ken Britton

cc: Mary Barcenez, Manager Retail