



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

Fiscal Year 2011 Financial Testing Compliance Oversight Reviews

Management Advisory Report

January 20, 2012

Report Number FI-MA-12-003



HIGHLIGHTS

IMPACT ON:

The U.S. Postal Service's Financial Testing Compliance (FTC) group and business areas related to postal retail units, plant-verified drop shipments, business reply mail, business mail entry units, detached mail units, and the SmartPay and Voyager purchase card programs.

WHY THE OIG DID THE AUDIT:

To evaluate whether the FTC group properly conducted and documented their examinations of key Sarbanes-Oxley Act (SOX) of 2002 financial controls. This audit was done in support of the independent public accounting (IPA) firm's reliance on management's testing and overall audit opinions on the Postal Service's financial statements and controls over financial reporting.

WHAT THE OIG FOUND:

The FTC group made significant improvements in their testing of key SOX financial reporting controls in fiscal year (FY) 2011. However, opportunities exist to improve the quality of conducting tests and documenting test results. We observed the FTC group conducting tests at 158 of the 1,023 sampled sites. We found the FTC group did not identify testing errors in four site reviews, did not perform steps in accordance with their program in three site reviews, and did not adequately document their work in two

site reviews. As a result, we did not always agree with FTC site results.

WHAT THE OIG RECOMMENDED:

We did not make recommendations in this report but provided our observations to the IPA firm and Postal Service management throughout the year. The IPA firm used the information to support its opinions on FY 2011 Postal Service financial statements and controls over financial reporting.

WHAT MANAGEMENT SAID:

Management agreed with the findings and reported they took corrective action throughout the year.

AUDITORS' COMMENTS:

We consider management's comments responsive to the findings, and corrective actions should resolve the issues identified in the report.

[Link to review the entire report](#)



January 20, 2012

MEMORANDUM FOR: TIMOTHY F. O'REILLY
VICE PRESIDENT, CONTROLLER

A rectangular box containing a handwritten signature in cursive that reads "John E. Cihota". In the top right corner of the box, there is a small yellow square icon with a black question mark.

FROM: John E. Cihota
Deputy Assistant Inspector General
for Financial Accountability

SUBJECT: Management Advisory – Fiscal Year 2011 Financial Testing
Compliance Oversight Reviews
(Report Number FI-MA-12-003)

This report presents the results of our review of the U.S. Postal Service's Financial Testing Compliance work at postal retail units (Project Number 11BR001FF000), plant-verified drop shipments units (Project Number 11BR002FF000), business reply mail units (Project Number 11BR003FF000), business mail entry units (Project Number 11BR004FF000), detached mail units (Project Number 11BR006FF000), and the SmartPay (Project Number 11BR007FF000) and Voyager (Project Number 11BR008FF000) purchase card programs.¹

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Denice Millett, director, Policy Formulation and Financial Controls, or me at 703-248-2100.

Attachments

cc: Joseph Corbett
Steven R. Phelps
Corporate Audit and Response Management

¹ The results of these projects were consolidated into this report under Project Number 11BR009FF000.

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Introduction

This report presents the results of our fiscal year (FY) 2011 Financial Testing Compliance (FTC) Oversight Reviews (Project Numbers 11BR001FF000, 11BR002FF000, 11BR003FF000, 11BR004FF000, 11BR006FF000, 11BR007FF000, and 11BR008FF000).² Our overall objective was to evaluate whether the FTC group properly conducted and documented their examination of key Sarbanes-Oxley Act (SOX) of 2002 financial reporting controls. This audit addresses financial risks. See [Appendix A](#) for additional information about this audit.

The Postal Accountability and Enhancement Act of 2006 requires the U.S. Postal Service to comply with Section 404 of SOX. To comply with Section 404 requirements, the Postal Service must report on the effectiveness of the agency's internal controls over financial reporting. It must submit an annual assessment and obtain an opinion regarding the effectiveness of those controls from its independent public accounting (IPA) firm and report to the Postal Regulatory Commission (PRC), who monitors and manages the Postal Service's compliance with SOX. The Postal Service identified and documented the key financial internal controls and conducted tests to determine the effectiveness of those controls. The U.S. Postal Service Office of Inspector General (OIG) reviewed the Postal Service's key financial controls and their testing plans for the controls. We provided evaluations of the controls to be tested and testing plans to the Postal Service and the IPA firm. The IPA firm maintains overall responsibility for making conclusions on the general evaluations, testing, and review of the internal controls tested. We conducted these oversight reviews in support of the IPA firm's reliance on Postal Service management's testing and overall audit opinions on the Postal Service's financial statements and internal controls over financial reporting.

Conclusion

The FTC group has made significant improvements in conducting and documenting their tests of key SOX financial reporting controls in FY 2011. However, we identified opportunities for the FTC group to improve the quality of conducting tests and documenting test results. We observed FTC staff conducting tests and reviewed their documented results at 158 of the 1,023³ sampled sites. Specifically, the FTC group did not always identify testing errors, perform steps in accordance with their audit program, and adequately document their work. As a result, we did not always agree with FTC site results. We communicated our oversight results to management and the IPA firm via weekly discussions and quarterly capping spreadsheets. Because the IPA firm used the information to support its opinions on FY 2011 Postal Service financial statements and controls over financial reporting, and Postal Service resolved the issues during the year, we are not making any recommendations. See [Appendix B](#) for more details on the sites where we noted issues.

² The results of these projects were consolidated into this report under Project Number 11BR009FF000.

³ The 1,023 represents the universe from which we pulled our sample. FTC did testing at additional sites.

FTC Testing

FTC analysts did not always identify and report testing errors. During our observations we noted four testing errors that FTC did not identify. Specifically:

- At one of 15 postal retail units (PRU) visited, unit personnel did not perform bank deposit preparation procedures consistent with Postal Service policies. Specifically, they failed to include a copy of the check register or a listing of checks with deposits. The FTC group did not report this error as an exception. The FTC analyst stated that, because two unit employees correctly witnessed the deposit preparation, exclusion of the check listing was not a sufficient reason to make the error reportable. We disagree with FTC's assessment that this error was not reportable. The FTC test program for this key control includes five bank deposit preparation procedures that FTC should confirm the unit is doing when preparing a deposit. Confirming inclusion of the check register or a listing of the checks and confirming that the preparer and witness, if available, did an independent count are two separate components of the control; therefore, FTC should have reported an exception.

In May 2011, the Postal Service's SOX Program Management Office evaluated key internal control processes at PRUs. They determined that unit level testing of the bank deposit preparation is not a key control for SOX certification. The Postal Service's accounting service center (ASC) conducts bank deposit reconciliations. The ASC does high-level monitoring and automated validations to identify banking discrepancies and record any differences. The ASC also notifies units of the differences and ensures the unit reconciles the bank deposit with the unit's daily financial report. As a result of management's evaluation, the control was moved from a unit-level test to an ASC-level test. We reviewed management's evaluation and rationalization for moving the bank deposit control test to a higher level control and agreed with their assessment.

Although management has determined that unit bank deposit preparation is no longer a key internal control for the purpose of SOX certification, the OIG and the IPA firm consider it critical to report all exceptions identified during testing. Without this information, management would be unable to assess the true nature of control failures and would be severely limited in their ability to take corrective action if necessary.

- At one of 45 business mail entry units (BMEU) visited, we noted the unit did not record two mailings in the *PostalOne!* system.⁴ The mailings were sitting on the dock during the unit's end-of-day reconciliation procedures. When the FTC analyst requested to see the postage statements in *PostalOne!* for the two mailings, BMEU personnel were unable to locate the statements because they had not entered the

⁴ The *PostalOne!* system is a suite of online services that allows the Postal Service to electronically collaborate with business mail customers, streamlines the mail acceptance and postage payment process, provides for mail verifications and job tracking, provides access to information, and eliminates paperwork.

statements into the system. According to management, FTC did not report this testing exception because unit personnel manually recorded the two mailings on Postal Service Form 8025, Mailer Notification Log for Disqualified Mail, and because the postage statements were incorrect. However, the FTC testing program requires the FTC analyst to confirm that unit personnel performing the end-of-day reconciliations have a process to identify mailings that may be present in the mail work area but have not been recorded on the *PostalOne!* reconciliation report. Also, for all statements that are not finalized, the analyst should confirm a reason code was entered into *PostalOne!*. When FTC analysts do not properly conduct internal control tests and identify and report all exceptions, management is unable to assess the true effectiveness of the control, which severely limits management's ability to take corrective action, if needed.

- At one of 32 detached mail units (DMU) visited, we noted testing issues related to mail verification⁵ procedures. Specifically, for three mailings the FTC analysts did not record all errors related to the unit verifying delivery addresses, tray labels to content and/or container labels, container integrity, or container labeling. In addition, one of the FTC analysts noted that for one mailing, unit personnel did not compare the *USPS Qualification Report*⁶ to the postage statement for completeness. We noted this procedure was not performed on two additional mailings. FTC management disagreed with our findings, stating that, for the observations noted, the OIG appeared to focus on the details of the exception rather than whether the control was operating effectively. FTC stated that the OIG's observation regarding the *Qualification Report* corroborated the observations of the FTC analyst and did not change the conclusion by FTC that the controls at the unit were not operating effectively. While we agree with FTC that the mail verification procedures were not functioning properly at the unit, it is important that FTC analysts document and report all exceptions so management can determine the pervasiveness of the control failure and determine the level of corrective action necessary to correct the exceptions noted.
- At one of 12 units we visited to observe SmartPay transaction testing, we noted the FTC analyst accepted a packing slip as supporting documentation for one transaction. This purchase was not properly supported by supplier/merchant itemized documentation showing the amount paid for the merchandise. The FTC group manager explained that the FTC group, in coordination with the process owners, initially agreed that a packing slip was adequate support for the SmartPay reconciliation process. However, after further discussion, the FTC group agreed with the OIG that more specific documentation is required and agreed to modify their review program steps. FTC has not updated its SmartPay program but plans to do so for FY 2012 testing. FTC stopped their SmartPay testing in Quarter 2, FY 2011

⁵ To qualify for Postal Service business mail prices, mailers are required to prepare mailings in accordance with specific mail preparation standards. Acceptance personnel must perform an initial verification on all submitted mailings and in-depth verification procedures at performance-based verification (PBV) sites when prompted by *PostalOne!* and when errors are identified during the initial verification.

⁶ Report that lists by ZIP Code™ the number of mailpieces qualifying for each rate by presort level. This report is also known as the production report.

because of the large number of control failures and because management was remediating those failures. We will review the updated SmartPay program when it is provided.

FTC Audit Program

FTC testers did not always follow their program as written. For example:

- At one of 45 BMEUs we visited, the FTC analyst entered the wrong date into their sample generator. Specifically, the FTC review program requires the analyst to enter a beginning date of January 1, 2011; however, the analyst erroneously entered January 11, 2011. As a result, transactions from January 1 through January 10, 2011, were erroneously excluded from possibly being selected for testing for this site. FTC management agreed with our finding.
- At one of 32 DMUs we visited, the FTC analyst did not confirm that DMU personnel performed all required mail verifications. Specifically, *PostalOne!* indicated a performance based verification (PBV) was to be performed on a mailing. Neither the FTC analyst nor the DMU clerk noticed a PBV was required until the OIG brought it to their attention at the end of the review. The DMU clerk then performed the PBV verification at the request of the FTC analyst. FTC did not report this as an exception. FTC management stated that, because the PBV verification was ultimately accomplished, it met the requirements for the test objective. We disagree with management's reason for not reporting this error as an exception. The OIG conducts these observations in part to evaluate whether FTC properly conducts and documents their examinations. The FTC analyst did not notice that a PBV was required until we brought it to their attention and, therefore, did not know there was an exception. In addition, it is doubtful that DMU personnel would have performed this verification if the OIG had not brought it to FTC's and the DMU clerk's attention.⁷
- At one of 12 units where we observed FTC testing SmartPay transactions, the FTC analyst used the wrong report to generate sample transactions for testing. Although we agreed with the analyst's conclusions on the transactions tested, the analyst did not test one transaction that would have been in the sample had he used the correct report to generate the sample. The group manager stated it was an error and agreed the FTC analyst made an error when generating the sample. When analysts do not follow their testing program, there is an increased risk that erroneous transactions will not be selected for testing.

⁷ Similar issues were identified in the OIG report titled *Mail Verification Procedures at Detached Mail Units* (Report Number [MS-AR-12-002](#), dated January 12, 2012). We found that employees performing mail verification procedures did not detect mailings with insufficient postage or mailings that did not meet Postal Service mailing standards. These conditions occurred because acceptance employees relied too heavily on mailers when verifying mail and were not aware of in-depth mail verification procedures.

FTC Documentation

FTC testers did not adequately document the work they performed. For example:

- At one of 32 DMUs we visited, testers did not include copies of postage statements in their documentation. Although the FTC analyst noted the unit did not perform required verification procedures and the postage statement was in error, the FTC testing program did not require personnel to include postage statements in their automated working papers to support exceptions noted.

FTC management disagreed with our finding, stating the inclusion of a specific postage statement is not applicable to support the exception noted. In addition, management explained that the objective for the control test was to ascertain that the unit, overall, is performing the required verification procedures to confirm the validity of revenue recognition.

Although we agreed with the FTC analysts' noted exception, we disagree that inclusion of postage statements containing errors is not applicable in supporting exceptions. Mail verification procedures are comprised of multiple steps and sub-steps. Exceptions within each of the steps and sub-steps should be noted, reported, and supported with appropriate documentation. The postage statements in question are both applicable and relevant to the exception noted and should either be included as part of the supporting documentation or described in sufficient enough detail that a third party could obtain the same postage statements and review or retest, if appropriate. Furthermore, as discussed previously in this report, we believe FTC should report every exception regardless of how many steps or sub-steps exist within a particular control. If all exceptions are not noted, reported, and adequately supported, management may not be able to properly understand the magnitude of the testing failures or to achieve the desired testing result.

- At one of 39 plant-verified drop shipment (PVDS) sites we visited, an employee gave an incorrect response to an interview question. However, FTC did not include this issue in their documentation. FTC management stated that testers should only include information relevant to a finding in their documentation and, because they did not consider this issue a finding, the tester did not include the employee's incorrect response in the documentation. However, after further discussions with FTC management, they decided to immediately implement a policy requiring analysts to include all responses provided during discussions in their documentation. FTC management stated they instructed their analysts in November 2011 to include all responses provided during discussions in their documentation. Complete and accurate documentation of review results provides management with a more accurate and complete understanding of the overall internal control environment of a unit.

Recommendations

We are not making recommendations in this report because we provided our observations to the IPA firm and Postal Service management throughout the year.

Management's Comments

Management agreed with the findings and reported they took corrective actions throughout the year. See [Appendix C](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the findings and corrective actions taken throughout the year should resolve the issues identified in the report.

Appendix A: Additional Information

Background

The Postal Accountability and Enhancement Act of 2006 requires the Postal Service to comply with Section 404 of SOX. To comply with Section 404 requirements, the Postal Service must report on the effectiveness of the agency's internal controls over financial reporting. It must submit an annual assessment to the PRC, who monitors and manages the Postal Service's compliance with SOX. The Postal Service must also obtain an opinion regarding the effectiveness of those controls from its IPA firm.

To meet these requirements, Auditing Standard Number 5⁸ allows the IPA firm to use the work performed by internal employees or contractors working under the direction of management in its assessment of the effectiveness of internal controls over financial reporting. The IPA firm requested the OIG to assist in reviewing FY 2011 field testing conducted by FTC at BMEUs, DMUs, PVDS units, PRUs, and business reply mail (BRM) units; as well as credit card transactions related to the SmartPay and Voyager purchases. FTC analysts tested the effectiveness of key field financial controls in support of SOX requirements and retested controls to ensure that management properly remediated those that previously failed.

Objective, Scope, and Methodology

Our overall objective was to evaluate whether FTC properly conducted and documented their examination of key SOX financial reporting controls. We conducted these oversight reviews in support of the IPA firm's reliance on management's testing and overall audit opinions on the Postal Service's financial statements and internal controls over financial reporting.

To accomplish our objective, we judgmentally selected 158 reviews from 1,023 possible testing sites and observed FTC staff conducting key financial control tests. In addition, we determined whether FTC provided supporting documentation for the work performed. Table 1 shows the reviews we observed, by review type and postal quarter.

⁸ *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, Public Company Accounting Oversight Board, dated July 27, 2007.

Table 1: Number and Type of OIG Oversight Reviews of FTC SOX Testing

	OIG Review of FTC Work				OIG Oversight Reviews	FTC SOX Testing
	Postal Quarter 1	Postal Quarter 2	Postal Quarter 3	Postal Quarter 4		
BMEU⁹	12	12	12	9	45	211
PRU	3	12	0 ¹⁰	0	15	120
BRM	3	0 ¹¹	0	0	3	60
PVDS	3	12	12	12	39	246
DMU	0 ¹²	12	12	8	32	286
SmartPay	0 ¹³	12	0 ¹⁰	0	12	60
Voyager	0 ¹⁴	12	0 ¹⁰	0	12	100
Totals	21	72	36	29	158	1,083¹⁵

Source: OIG

We conducted this review from November 2010 through January 2012 in accordance with the Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Inspection and Evaluation*. We discussed our observations and conclusions with management on December 19, 2011, and included their comments where appropriate.

We assessed the reliability of computer-generated data by verifying it to source records. We determined that the data were sufficiently reliable for the purposes of this report.

Prior Audit Coverage

We issued one prior report related to the oversight of FTC's work: *Fiscal Year 2010 Quality of Postal Service Financial Testing and Compliance Results* (Report Number [FF-MA-11-001](#), dated January 3, 2011). The report did not include monetary impact. We stated FTC did not report all exceptions they identified during their reviews, causing their results to not always be consistent with the OIG's results.

Further, we were sometimes unable to determine whether the OIG's and FTC's results were consistent because of insufficient FTC supporting documentation. We also noted other working paper documentation issues, such as FTC not providing all sampling methodology documentation to the OIG. However, this did not affect our ability to determine whether FTC's and the OIG's results were consistent. Most of the issues we identified were in reviews FTC conducted early in their testing schedule. Given that FTC

⁹ FTC tested key controls at BMEUs using two sampling methods: one sample for the top 60 revenue-generating units (representing 50 percent of BMEU revenue) and one randomly generated sample for BMEU units with revenue greater than \$1 million. We observed FTC's BMEU testing at the top 60 units only and these units were tested each quarter.

¹⁰ FTC stopped testing PRUs in Quarter 3 to remediate control failures and review those controls deemed as key to ensure the control was being tested at the proper level.

¹¹ FTC halted BRM, SmartPay, and Voyager testing after Quarter 2 so that control testing failures could be addressed and remediated. These controls were not remediated or tested for the remainder of the fiscal year.

¹² The OIG did not select any DMUs for observations in Quarter 1 due to a change in DMU controls and sample.

¹³ FTC did not test SmartPay purchase cards in Quarter 1 due to limited number of transactions available at the time.

¹⁴ FTC did not test Voyager purchase cards in Quarter 1 due to limited number of transactions available at the time.

¹⁵ FTC tested 60 DMU's in Quarter 1, and the OIG did not test any. Thus, the OIG's sample universe was 1,023 compared to FTC's 1,083.

was a newly formed group and analysts were learning new jobs and implementing new review programs, we expected these results. Throughout the year, we communicated these issues to management, who agreed with our findings and reiterated that they took corrective action throughout the year.

Appendix B: Oversight Reviews with Exceptions

Review Type and Site Name	Errors Not Identified or Reported by FTC	Program Steps Were Not Followed	Work Performed Not Adequately Documented
PRU			
[REDACTED]	X		
PVDS			
[REDACTED]			X
BMEU			
[REDACTED]	X		
		X	
DMU			
[REDACTED]	X	X	X
SmartPay			
[REDACTED]			
[REDACTED]	X		
Total	4	3	2

Appendix C: Management's Comments

TIMOTHY F. O'REILLY
VICE PRESIDENT, CONTROLLER



January 17, 2012

SHIRIAN HOLLAND
ACTING DIRECTOR, AUDIT OPERATIONS

SUBJECT: Response to Draft Management Advisory – Fiscal Year 2011
Financial Testing Compliance Oversight Reviews

Thank you for the opportunity to respond to your audit of the Financial Testing and Compliance (FTC) work at postal retail units (PRU), plant-verified drop shipment units (PVDS), business reply mail units (BRMU), business mail entry units (BMEU), detached mail units (DMU), SmartPay and Voyager purchase card programs. Although there were no recommendations made in the report, there were opportunities for improvements identified. Management agrees with the findings and, as noted in this report, has taken corrective actions throughout FY11 to address each of these findings.

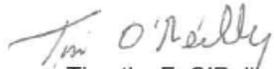
The opportunities for improvement identified were in the areas of enhanced workpaper and sampling documentation. These issues were identified early in FY11 and were addressed through an aggressive training and enhanced review process. The training focused on workpaper preparation, strengthening of test script objectives, and increased knowledge surrounding control evaluations. In addition to making certain that all aspects of the review process were thoroughly and accurately documented, enhanced higher level reviews were conducted to ensure that all appropriate documentation supported the testers conclusions and that the FTC results were consistent across all reviews.

Management is appreciative of the feedback from your team as it provided a better standardized workpaper documentation process that continues to improve. We appreciate the opportunity to provide feedback to this draft report. If you have any questions or need additional information, please contact Douglas Germer, Manager, Financial Control and Support at (202)268-8522.

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This report and management's response do not contain information that may be exempt from disclosure under the Freedom of Information Act (FOIA).



Timothy F. O'Reilly
Vice President, Controller

cc: Joseph Corbett
Steven R. Phelps
Corporate Audit Response Management