

February 14, 2003

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ANITA J. BIZZOTTO
SENIOR VICE PRESIDENT, CHIEF MARKETING OFFICER

KEITH STRANGE
VICE PRESIDENT, SUPPLY MANAGEMENT

SUBJECT: Audit Report – Mail Product Supplies
(Report Number AC-AR-03-002)

This report presents the results of our self-initiated review of mail product supplies. This review was initiated as a result of our audit survey of the Postal Service Logistics Systems (Project Number 01NR002AC002).

Background

The Postal Service offers standard, specialized, and customized Priority Mail and Express Mail packaging products to customers. These products include envelopes, boxes, mailing labels, and tape. In fiscal year (FY) 2001, over \$138 million was spent by the Postal Service on mail product supplies. Standard packaging is available to all customers at their local Post Office or by ordering directly from the Express and Priority Mail supply centers. Specialized packaging is an additional selection of boxes and envelopes for customers who can accept and store large volumes of products. Customized packaging is available to customers who meet the minimum criteria in new business annually, and when neither standard nor specialized packaging will meet their needs. These three types of packaging supplies are purchased by the Postal Service and are available at no cost to the customer.

Objective, Scope, and Methodology

Our objective was to evaluate how mail product supply requirements are determined and whether the amount of supplies purchased and stored was appropriate. To accomplish our objective, we interviewed Postal Service Purchasing, Marketing, and district officials on their policy and procedures for product supply requirements, budgeting, and managing excess mail product supplies in field locations. We reviewed

and analyzed customer supply order documentation and the replenishment formula used for forecasting future purchases for standard supplies. We interviewed Postal Service contractors responsible for forecasting future purchases and managing supplies. We also selected a statistical sample of 33 districts to conduct site visits, and perform inventories of mail product supplies stored in Postal Service facilities. (See Appendix A.)

This audit was conducted from April 2002 through February 2003, 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 conclusions and observations 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.

Results

Our review found that mail product supply requirements were sometimes overstated. Budget requests for mail product supplies did not consider on-hand balances of specialized and standard packaging supplies in Postal Service facilities at the district level. As a result, we project that approximately \$1.2 million in excess standard packaging supplies and about \$430,000 in excess specialized packaging supplies could be used to reduce mail product supply expenses for FY 2003. In addition, we found that personnel in 12 of 33 districts had also established or maintained local product fulfillment operations to manage excess mail product supplies. Postal Service officials in 7 of the 12 districts estimated that \$102,000 was spent during FY 2002 to manage excess package supplies at the same time the Postal Service was paying a contractor for this service under an existing contract.

Excess Specialized and Standard Packaging Supplies

Mail product supply requirements were sometimes overstated. We visited 33 districts to determine the existence of excess supplies. The amount of supplies ordered from manufacturers was based on customer orders and forecasted volume projections. However, on hand balances for standard and specialized packaging supplies in district Postal Service facilities were not considered when Postal Service Headquarters placed orders with manufacturers.

We also found that procedures did not require district personnel to return excess mail product supplies to the Express and Priority Mail supply centers. Furthermore, Postal Service Purchasing officials were not aware that excess product supplies were on hand. As a result, FY 2003 mail product supply orders to manufacturers were overstated and product replenishment costs could be reduced.

We project that approximately \$1.2 million in excess standard packaging supplies and about \$430,000 in excess specialized packaging supplies could be used to reduce mail product supply expenses for FY 2003. Using these supplies prior to ordering additional supplies would allow headquarters to reduce product replenishment costs for FY 2003. The following photo is an example of excess supplies in a Postal Service facility.



Excess packaging supplies in storage at a district Postal Service facility

Districts are Duplicating Established Product Fulfillment Operations

District personnel in 12 of the 33 districts we visited had established local product fulfillment operations to manage excess mail product supplies. District personnel believed that by managing these supplies locally, they provided faster service to their customers. Customers were either allowed to store and pick up orders from district facilities or had orders delivered from inventory to their facilities using Postal Service transportation. However, according to Publication 247, Supply and Equipment Catalog, dated May 2002, customers should be ordering standard supplies through the Express and Priority Mail supply center. Customers should be ordering specialized supplies through Postal Service Headquarters in accordance with the Postal Service Packaging Program Standard Operating Procedures dated December 1997.

Personnel in 7 of the 12 districts sampled estimated spending over \$102,000 to manage product fulfillment locally in FY 2002. However, the Postal Service was already paying a contractor \$28 million over 3 years to manage mail product supplies at the national Express and Priority Mail supply centers. According to the statement of work, the contractor is responsible for all phases of product fulfillment operations, database and inventory management, forecasting, order processing, distribution of supplies and

reporting. Therefore, districts are needlessly maintaining supplies locally. The following photo is an example of district product fulfillment operations.



Example of district product fulfillment operations

Recommendation

We recommend the vice president, Supply Management, and the senior vice president, chief marketing officer:

1. Ensure that excess supplies in district offices are used prior to purchasing additional mail product supplies.

Management's Comments

Management agreed with our recommendation stating that district offices will be directed to exhaust excess inventory and enforce standard operating procedures, which outline procedures for customer orders and maintaining supplies. Management's comments, in their entirety, are included in Appendix B of this report.

Recommendation

We recommend the vice president, Supply Management, and the senior vice president, chief marketing officer:

2. Reduce FY 2003 budget for standard and specialized supplies by \$1.6 million.

Management's Comments

Management stated they have reduced the FY 2003 budget to reflect the presence of the supplies in the districts.

Recommendation

We recommend the vice president, Supply Management, and senior vice president, chief marketing officer, in coordination with the senior vice president, Operations:

3. Discontinue district product fulfillment and enforce the requirement for Postal Service facilities to order mail product supplies from the Express and Priority Mail supply centers or Postal Service account managers.

Management's Comments

Management stated that current operating procedures require both post offices and customers to order from the Express and Priority Mail supply centers, and requested a list of the facilities visited by the Office of Inspector General to begin exhausting these supplies. Further, in discussions with Operations staff, they agreed with the response from the chief marketing officer and actions are being taken to respond to all findings and recommendations.

Evaluation of Management's Comments

Management's comments are responsive to recommendations 1 through 3 and the actions taken and planned should correct the issues identified in the report.

We appreciate the cooperation and courtesies provided by your staff during our review. If you have any questions or need additional information, please contact Larry Chisley at (813) 261-5200, or me at (703) 248-2300.

B. Wayne Goleski
Assistant Inspector General
for Core Operations

Attachment

cc: Susan M. Duchek

APPENDIX A. STATISTICAL SAMPLING AND PROJECTIONS

Purpose of the Sampling

One of the objectives of this audit was to determine whether the amount of supplies stored at Postal Service facilities was appropriate. In support of this objective, the audit team employed a stratified random sample of Postal Service districts. The sample design allows statistical projection of the value of excess mail product supplies, in both standard and specialized categories, nationwide.

Definition of the Audit Universe

The audit universe consisted of 81 districts. From the possible universe of 85 districts, three Postal Service districts were eliminated from consideration because of audit resource constraints (Alaska, Hawaii, and Caribbean), and one was eliminated because the facility involved was not available for audit (Brentwood).

Sample Design and Modifications

The sample size was based on a stratified sample design. We calculated a desired sample size of approximately 33 sites, to obtain a two-sided confidence interval with 20 percent relative precision at the 90 percent confidence level. The variability for the sample size calculation came from that observed in the total value of the excess stock (not separated into the standard and specialized categories) found at five judgmentally selected survey sites. The five survey sites were treated as a census stratum (stratum I), and 28 sites were randomly selected from the remaining 76 sites in stratum II.

Selections for inclusion in the sample were made using the “randbetween” function in Excel to assign random numbers to the items on the universe listing for stratum II.

Statistical Projections of the Sample Data

For projection of the value of excess mail product supplies (standard and specialized) in the audit universe of 81 districts, the sample data were analyzed using the formulas for estimation of a population total for a stratified random sample, as described in Elementary Survey Sampling, Scheaffer, Mendenhall, and Ott, c.1990.

The projections do not apply to the four district exceptions noted in the universe description.

Based on projection of the sample results, we are 90 percent confident the value of excess standard mail product supplies is between \$.9 million and \$1.5 million. The unbiased point estimate is \$1.2 million in excess standard mail product supplies. The

relative precision for this category (+/- 25 percent) is consistent with that expected for the sample size used, given that the variability for individual categories was not considered in the design and that the preliminary sample was a judgment sample.

Based on projection of the sample results, we are 90 percent confident the value of excess specialized mail product supplies is between \$.26 million and \$.6 million. The unbiased point estimate is \$.43 million in excess specialized mail product supplies. The relative precision for this category is poor (+/- 40 percent) because the sample size was based on the variability observed for total excess rather than that specific to a particular product type.

APPENDIX B. MANAGEMENT'S COMMENTS

SUPPLY MANAGEMENT



December 9, 2002

B. WAYNE GOLESKI
ASSISTANT INSPECTOR GENERAL FOR CORE OPERATIONS

THRU: KEITH STRANGE

KS

SUBJECT: Draft Audit Report – Mail Product Supplies
(Report Number AC-AR-02-DRAFT)

Thank you for the opportunity to review and comment on the subject draft audit report. Although the Supply Management vice president is included as an addressee in each of the report's recommendations, we are not the appropriate organization to indicate agreement or disagreement with the report's findings and recommendations.

Supply Management is responsible for administering the indefinite delivery contracts that replenish mail product supplies to the Express and Priority Mail Supply Centers. As you know, we rely on the expertise of the requirements organization, customer orders and forecasted volume projections for placing replenishment orders. Any additional district product fulfillment activities do not fall under the purview of Supply Management.

Your report is already addressed to officials in Operations and Marketing who represent the appropriate organizations for responding to the report's findings and recommendations. Supply Management will support their decisions and if applicable, render assistance with recommendation implementation.

If any of the dollar amounts cited in this report will appear in the Inspector General's Semiannual Report to Congress, please advise in the final report how they will be discussed or categorized. If you have any questions regarding this response please contact Marie Martinez at (202) 268-4117.

A handwritten signature in black ink that reads "Juanda J. Barclay". The signature is fluid and cursive, with the first name "Juanda" being the most prominent.

Juanda J. Barclay, C.P.M., A.P.P.
Manager
Supply Management Infrastructure

cc: John A. Rapp
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JOHN A. RAPP
SENIOR VICE PRESIDENT
OPERATIONS



December 19, 2002

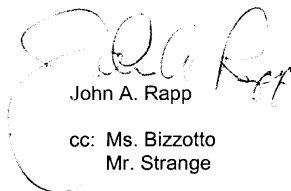
B. WAYNE GOLESKI
ASSISTANT INSPECTOR GENERAL
FOR CORE OPERATIONS

SUBJECT: Draft Audit Report – Mail Product Supplies
(Report Number AC-AR-03-DRAFT)

This responds to your November 18 Draft Audit Report on Mail Product Supplies. We agree with the need to have the most efficient inventory operations possible and for the most part it appears that the field is doing a pretty good job of managing mail product supplies. Of the \$138 million that is spent for such supplies, it appears there is about \$1.6 million that could be better controlled or 1.2 percent of the budget.

Marketing, Supply Management, and Operations will form a small working group to respond to the three recommendations you have presented within the next 30 days. We need to look at the impact on our customers on some of these recommendations; there is nothing worse than running out of supplies for customers. As for the fulfillment centers, I would like to coordinate with the areas to determine how they operate and what they are supplying. I do not think it is unreasonable to have some emergency backup in the districts should somebody run out of supplies but I do not think we should have fully staffed operations just for mailing supplies.

Fred Hintenach, manager, Customer Service Operations will coordinate this effort.



John A. Rapp

cc: Ms. Bizzotto
Mr. Strange

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ANITA J. BIZZOTTO
CHIEF MARKETING OFFICER
SENIOR VICE PRESIDENT



December 19, 2002

B. WAYNE GOLESKI

SUBJECT: Draft Audit Report (AC-AR-03-DRAFT) – Mail Product Supplies

We have reviewed your November 18 correspondence and agree with the conclusions drawn from the audit. Although some of the activities taking place in the field are intended to better satisfy customers, we do not endorse these practices due to their considerable costs. Overall, it is recognized that the need for additional customer convenience must be balanced against the cost to the Postal Service of achieving it.

Accordingly, we fully intend to assist in capitalizing on the specific areas of opportunity identified by the audit for program cost curtailment. This means reiterating standard operating procedures already in place which outline the core items available to post offices, as well as procedures for customer orders. Ordering procedures do not, and will not, include maintaining supplies inventory for re-distribution from a district facility.

OIG Recommendations

1. Ensure that excess supplies in district offices are used prior to purchasing additional mail product supplies.

Management Response:

District offices will be directed to exhaust excess inventory on hand within a reasonable period of time. The instruction for post offices to place orders directly through the supply center will be reiterated and enforced thereafter.

2. Reduce FY2003 budget for standard and specialized supplies by \$1.6 million.

Management Response:

Per earlier conversations with members of the audit team, the packaging supplies budget has already been reduced to reflect the presence of field inventory. This year's budget of \$86 million represents a 22 percent decrease from the \$110 million spent in FY2002.

3. Discontinue district product fulfillment and enforce the requirement for Postal Service facilities to order mail product supplies from the Express and Priority Mail supply center or Postal Service account managers.

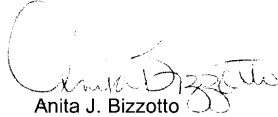
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Management Response:

The current standard operating procedure requires both post offices and customers to order from the Express and Priority Mail supply center. The only exception to this process would be in cases when select customers are in need of specialized or customized packaging. These customers should be in contact with their Postal Service sales representative, who will in turn contact the Expedited Packaging Supplies team at USPS headquarters. Fulfillment of specialized and customized supplies is made directly from the manufacturer to the customer facility.

To assist in our efforts, please provide us with a list of the facilities visited by Office of Inspector General representatives as part of the field audit so that we may contact them directly.

We appreciate your recommendations and will continue to support cost curtailment activities reflective of our commitment to financial responsibility.



Anita J. Bizzotto

cc: John Rapp
Keith Strange