November 4, 2004

EDUARDO H. RUIZ
MANAGER, SANTA ANA DISTRICT

SUBJECT: Audit Report – Self-Service Vending Program – Santa Ana District (Report Number DR-AR-05-007)

This is one of a series of audit reports on the Self-Service Vending Program in the Pacific Area. The report presents the results of our self-initiated audit on the Self-Service Vending Program in the Santa Ana District (Project Number 04YG016DR001). The information in this district report will be included in a report to the Pacific 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 Pacific Area had 3,325 pieces of vending equipment that generated over $145 million in revenue, of which the Santa Ana District maintained 12 percent (413) of the total area machines that generated over 23 percent ($32.7 million) of the total area vending revenue. During the first quarter of FY 2004, the Pacific Area had 3,395 pieces[1] of vending equipment that generated over $37.3 million in revenue, of which the Santa Ana District maintained 12 percent (414) of the total area machines that generated over 23 percent ($8.7 million) of the total area vending revenue.

[1] During the first quarter of FY 2004, the Pacific Area had 70 additional vending machines and the Santa Ana District had 1 additional vending machine.

1735 N Lynn St.
Arlington, VA 22209-2020
(703) 248-2100
Fax: (703) 248-2256

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 413 vending machines operating in the Santa Ana District in FY 2003, 11[2] were classified as obsolete based on Postal Service guidance, while the remaining 402 were classified as current equipment. For the first quarter of FY 2004, 414 vending machines were operating in the Santa Ana District, of which 12[3] were classified as obsolete, and the remaining 402 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.[4] 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 Santa Ana District was conducted from March through October 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

[2] This number includes one currency changer that does not generate revenue. The remaining 10 obsolete machines generate revenue.
[3] This number includes one currency changer that does not generate revenue. The remaining 11 obsolete machines generate revenue.
[4] Obsolete equipment was not included in the minimum revenue analysis.

could improve their process for redeploying vending equipment that does not meet minimum revenue requirements. In FY 2003, 54 percent (857 of 1,573 machines) of the vending 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 Santa Ana 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, Santa Ana District officials could increase revenue opportunities by redeploying equipment that does not meet minimum revenue requirements. Further, Santa Ana District officials could possibly reduce maintenance and repair costs by discontinuing the use of obsolete equipment. However, our physical observation of vending machines in the Santa Ana District indicated that overall the machines were operational and easily accessible.

Redeployment of Vending Equipment

Santa Ana District officials could improve their process for redeploying vending equipment that does not meet Postal Service minimum revenue requirements. Specifically, during FY 2003, our review of the vending equipment revenue reports indicated that 26 percent (106 of the 402 machines) of the vending machines did not meet the minimum revenue requirements. Vending equipment sales were approximately $2.1 million, which was significantly less than the minimum revenue requirement of $4.1 million. As a result, the Santa Ana District may have missed revenue opportunities of approximately $600,000 to $1.9 million by not redeploying this equipment.[5]

Additionally, during the first quarter of FY 2004, our review of the vending equipment revenue reports indicated that 26 percent (103 of the 402 machines) of the vending machines did not meet the minimum revenue requirements. Vending equipment sales were approximately $513,000, which was significantly less than the minimum revenue

[5] 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 $600,000 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 $1.9 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.

requirement of $909,000. As a result, the Santa Ana District may have missed revenue opportunities of approximately $396,000 by not redeploying this equipment.

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 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 took action to redeploy two vending machines that did not meet minimum revenue requirements during FY 2003.[6] For the remaining 104 machines, district officials did not initiate any redeployment action. Additionally, during the first quarter of FY 2004, district officials did not initiate any redeployment actions for the 103 underperforming machines. District officials did not initiate any redeployment action for the underperforming vending machines during FY 2003 and the first quarter of FY 2004 because of concern for the potential adverse impact on customer service due to the nonavailability of machines. District officials indicated that the required replacement equipment needed for the redeployable locations, have not yet been allocated to the district location. In addition, due to the consolidation of Pacific Area Districts in FY 2003, the Santa Ana District received 20 underperforming machines from another district. By not taking action to redeploy underperforming equipment, the district could miss revenue opportunities during the remainder of FY 2004.

District officials also expressed concern regarding the Postal Service's methodology to establish minimum revenue requirements, and that the current requirements are too high in relation to the machines geographic locations. We plan to forward the district's concern to Postal Service Headquarters.

We discussed the results with Santa Ana 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 plan to reassess vending

[6] Our review of the revenue reports for the first quarter of FY 2004 indicated that this machine's revenue did meet minimum revenue requirements.

machine locations based on trend analysis of historical vending data and receipt of 73 automated postal centers.[7]

Recommendation

We recommend the Manager, Santa Ana District, direct the Retail Manager to:

1. Continue to 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 the recommendation and has initiated steps to identify underperforming equipment through the use of the Equipment Relocation Analysis Report (ERA) and Performance Analysis Vending Report from the VESS. Management will issue low revenue generation letters to postmasters with underperforming equipment by October 15, 2004, and follow with work orders to assure maximized redeployment. Additionally, all retail supervisors will attend four sessions of mandatory retail training that includes vending program requirements. The last training session will be conducted on September 24, 2004. Management provided an addendum to their comments stating that not all multi-commodity machines should be relocated based on location, customer demographics, and minimal debit/credit card usage when customers may not benefit from automated postal centers.

Additionally, management expressed concerns regarding the total number of vending machines and revenue generated as identified in this report. Management stated that the Santa Ana District had 380 vending machines instead of 402 in FY 2003 based on their review of the ERA report from VESS. Management also stated that total revenue was $33 million instead of $2.1 million in FY 2003, based on their review of the Performance Analysis Minimum Vending Report from the VESS. Management's comments, in their entirety, are included in the appendix of this report.

Evaluation of Management's Comments

Management's comments are responsive to our recommendation. Management's planned actions should correct the issues identified in the finding. Regarding management concerns of our data for total vending machines and revenue, the difference is due to the data source and the methodologies used to arrive at the totals for the Santa Ana District. The vending universe of 380 machines was based on the Equipment Relocation Analysis Report, which excluded 8 obsolete machines and 25 current machines, which were included in VESS and identified in the vending

[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.

revenue reports data provided by district officials to the OIG in April 2004. The total revenue of $33 million was based on the entire vending machine universe, while the $2.1 million was based solely on the revenue generated for the underperforming machines included as part of the universe.

Use of Obsolete Equipment

In FY 2003, Santa Ana District officials continued to use 10[8] obsolete machines and possibly incurred maintenance and repair expenses, even though Postal Service policy discontinued the maintenance and repair support for the machines in June 2000.[9] Our review of vending equipment revenue reports indicated that 60 percent (6 of the 10 machines) of the vending machines did not meet minimum revenue requirements during FY 2003. During the first quarter of FY 2004, district officials continued to use 11[10] obsolete machines, of which 7 (64 percent) of the 11 machines did not meet the minimum revenue requirements.

District officials stated that they continued to use and maintain the obsolete equipment because of 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 of repair and maintenance expenses associated with the machines because the Postal Service does not capture the data for each machine.[11]

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 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 cost

[8] This number does not include one change machine that does not generate revenue.
[9] This policy supplements Maintenance Management Order, 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.
[10] This number does not include one change machine that does not generate revenue.
[11] We plan to address this issue in a capping report to Postal Service Headquarters officials.

to operate it. District officials plan to replace the obsolete machines when the new automated postal center machines are deployed to the district location.

Recommendation

We recommend the Manager, Santa Ana 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 the finding and recommendation and stated work orders were initiated in March 2004 to remove the obsolete machines; however, delays occurred due to the deployment of 73 automated postal centers from April through July 2004. Management stated nine obsolete machines have been removed as of September 15, 2004. The remaining two machines cannot be removed. One machine is imbedded in marble at a historical site and the other machine is located in a hotel and will be removed at the owner's expense in one to two years.

Evaluation of Management's Comments

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

The OIG considers recommendations 1 and 2 significant, and therefore requires OIG concurrence before closure. Consequently, the OIG request written confirmation when corrective action(s) are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

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, or me at (703) 248-2300.

/s/ Mary W. Demory

Mary W. Demory
Deputy Assistant Inspector General
for Core Operations

Attachment

cc: Alfred Iniguez
Florinda M. Bailey
Karen A. Doyle
Kathleen S. Miller
Steven R. Phelps

APPENDIX. MANAGEMENT'S COMMENTS

DISTRICT MANAGER
SANTA ANA DISTRICT

UNITED STATES
POSTAL SERVICE

October 1, 2004

Kim H Stroud
Director, Audit Operations
USPS-OIG
1735 North Lynn Street
Arlington VA 22209-2020

Subject: Addendum to Response to Draft Audit Report-Self Service Vending Program Santa Ana District (Report Number DR-AR-04-DRAFT).

Attached is an addendum to the response submitted to the audit findings and recommendations made for the Santa Ana Self-Service Vending Program (Project Number 04YG016DR001).

Please advise me if you have any questions or concerns. Your assistance is appreciated.

Eduardo H Ruiz, Jr
District Manager
Santa Ana District

cc: John A Rapp
Alfred Iniquez
Florinda Bailey
Karen A Doyle
Kathleen S Miller
Steven R Phelps
Winnie Groux

3101 W Sunflower Avenue
Santa Ana CA 92799-9362
714-662-6300
Fax: 714-557-5837

MANAGER, MARKETING
SANTA ANA DISTRICT

UNITED STATES
POSTAL SERVICE

September 30, 2004

Mary Demory
Deputy Assistant Inspector General
For Operations and Human Capital

SUBJECT: Addendum to Draft Audit Report-Self-Service Vending Program-Santa Ana District (Project Number DR-AR-04-DRAFT, Project Number 04WG003DR001).

Recommendation:

We recommend the Manager, Santa Ana District, direct the Retail Manager to:

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

Addendum to Audit Response Dated September 16, 2004:

The Retail Manager has prepared and reviewed a list of machines not meeting minimum revenue targets and has begun notifying Postmasters of vending program revenue requirements. Each machine has been evaluated, based on possible redeployment, and it has been determined that not all multi-commodity machines should be relocated. Based on location and customer demographics, it is in the interest of the Postal Service to retain current vending equipment to provide this alternate access to a customer base with minimal debit/credit card usage, and, therefore, unable to benefit from the Automated Postal Center.

Florinda Bailey

Florinda M Bailey
Manager, Marketing
Santa Ana District

3101 W SUNFLOWER AVENUE
SANTA ANA CA 92799-9362
714-662-6223
FAX: 714-434-6656

SANTA ANA DISTRICT MANAGER

UNITED STATES
POSTAL SERVICE

September 16, 2004

Kim H. Stroud
Director, Audit Operations
USPS-OIG
1735 North Lynn Street
Arlington VA 22209-2020

Subject: Response to Draft Audit Report-Self-Service Vending Program
Santa Ana District (Report Number DR-AR-04-DRAFT),

Attached is the response from the Manager, Marketing to the audit findings and recommendations made for the Santa Ana Self-Service Vending Program (Project Number 04YG016DR001). The discrepancies identified during the audit have been corrected, as stated on the attached.

Please advise me if you have questions or concerns. Your assistance is appreciated.

Eduardo H Ruiz, Jr.
District Manager
Santa Ana District

cc: John A Rapp
Alfred Iniquez
Florinda M Bailey
Karen A Doyle
Kathleen S Miller
Steven R Phelps

714-662-6300
FAX:

SANTA ANA DISTRICT MANAGER

UNITED STATES
POSTAL SERVICE

September 16, 2004

Mary Demory
Deputy Assistant Inspector General
For Operations and Human Capital

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

This is in response to your audit on the Self-Service Vending Program in the Santa Ana District (Project Number 04WG003DR001).

Recommendation:

We recommend the Manager, Santa Ana District, direct the Retail Manager to:

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

Response:

The Santa Ana District agrees with this recommendation and has initiated steps to identify and redeploy underperforming vending equipment through use of the Equipment Relocation Analysis Report and Performance Analysis Minimum Report from the Vending Equipment Service System (VESS). Low revenue generation notices are being sent to each Postmaster with a completion date of October 15, 2004. Work orders will follow to assure maximized redeployment of equipment. Twenty one (21) of the underperforming machines are the only piece of vending equipment in the Postal facility. Forty (40) pieces are at offsite locations with most in hotels or at Disneyland or other tourist locations that present an opportunity to provide at least some level of product availability to our customers. Although the VESS system recommends removal of many machines, the recommended replacement equipment is noted "none available" in forty six cases.

The Retail Manager has prepared a list of machines not meeting minimum revenue targets and has begun notifying each Postmaster of vending program requirements through low revenue generation notices as required by the P-102. This notification process will be completed no later than October 15, 2004. This list will continue to be modified to assure

FAX:

redeployment of underperforming machines is optimized and that each piece of vending equipment is profitable to the Postal Service.

Additionally, the Santa Ana Performance Cluster has scheduled four sessions of retail training, including vending program requirements beginning Thursday, September 16th. All retail supervisors will attend this mandatory training. The last session will be conducted on September 24, 2004.

While management agrees with the foregoing recommendation it disputes some numerical data in the draft of this report. According to VESS reports (Relocation Analysis generated for FY 2003, there were 380 machines, not 402 (draft count may include currency changers and WRU units). Ninety, not 102, did not meet minimum revenue based on average monthly revenue as outlined in the P0-102, Self Service Vending Handbook. This represents approximately 23 percent of our equipment. Only one piece of obsolete equipment failed to meet minimum revenue requirements in FY 2003.

Additionally, vending equipment sales for FY 2003 were $33,034,943 not $2.1 million as stated. The ninety (90) machines not meeting revenue minimums generated $134,850 against a target of $267,490. All remaining machines outpaced expectations leading the Cluster to realize $18.2 million in sales over the minimum revenue required.

Machine Type	Count	Required Monthly Revenue	District Average per Machine	Revenue Req'd by Machine Type per FY	Total Actual Sales
SVM	66	$ 500 x 66= $33,000	$ 914	$ 429,000	$ 999,118
BVM	19	$ 550 x 19= $10,450	$ 442	$ 135,850	$155,438
BSM	131	$ 2130 x 131= $279,030	$7,338	$ 3,627,390	$13,069,582
MCM	164	$ 5,000 x 164= $820,000	$8,129	$ 10,660,000	$18,810,805
Totals	380	$1,142,480		$ 14,852,240	$33,034,943

Source: VESS Equipment Relocation Analysis Report and Performance Analysis Minimum-All Machines FY 2003, AP 13 YTD

Revenue opportunities by redeploying machines not making minimum revenue is calculated to be $1.7 million dollars, or 5% of our total vending revenue.(This calculation assumes that all machines will perform to minimum revenue requirements in new locations).

For Quarter 1 of FY 2004, vending revenue overall is $8,692,752 (through Dec 2003) and not $ 513,000 as stated in the draft report (source: VESS).

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

The Santa Ana District agrees with this finding. Work orders were initiated in March, 2003 for the removal of eleven pieces of obsolete equipment. Completion of all work was delayed as resources were appropriated to tasks required for deployment of seventy three Automated Postal Centers across the Cluster from April to July, 2003.

To date, eight of eleven (72%) pieces of obsolete equipment have been removed. Two pieces cannot be moved; one PS 86 is imbedded in marble at an Historical site (Downtown Station, Long Beach). The other is located in a special postal unit built by the Hilton Hotel (at their expense) near Disneyland. The PS 86 located there will be removed when major hotel renovation is completed in one to two years. Maintenance employees were at the Carson Branch to remove the final piece of obsolete equipment on September 15, 2004.

The Santa Ana District Retail Manager will continue to monitor all vending equipment and the revenue generated at each location on an ongoing basis to assure that minimum revenue requirements are met, redeployment of equipment is accomplished when necessary and that each machine is profitable to the Postal Service.

Thank you for the opportunity to respond to this draft report.

Florinda M. Bailey
Manager, Marketing
Santa Ana District