

September 28, 2001

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SUBJECT: Audit Report – Stamp Printing Quantities
(Report Number MK-AR-01-002)

This report presents the results of our audit of the Postal Service's stamp printing quantities (Project Number 00RA055RG000). The report responds to a self-initiated audit by the Office of Inspector General (OIG). Our audit objectives were to determine whether the Postal Service printed the appropriate quantity of stamps to meet their customer needs and whether saleable stamps were being destroyed. We accomplished our objectives by reviewing the stamp acquisition and destruction processes.

The audit revealed that fiscal year (FY) 2001 quantities scheduled for printing at the Bureau of Engraving and Printing will exceed demand by 5.2 billion stamps and stamp printing requirements for FY 2002 will exceed demand by 3.5 billion stamps. In addition, we identified about 462 million saleable stamps, with a retail value of \$99.4 million at the Dulles Stamp Services Center that were destroyed instead of being returned to inventory for redistribution during FY 2000. The cost to produce these stamps was \$1.4 million, which we consider to be unrecoverable costs that could have been avoided.

We recommended Postal Service management reduce the FY 2002 overall stamp quantities by approximately 3.5 billion stamps. Management agreed with the recommendation which would allow them flexibility in responding to inventory needs for an expected rate change to occur in FY 2003. As a result, approximately \$10 million in printing costs will be saved in FY 2002.

We also recommended Postal Service management establish future stamp printing requirements based on forecasted shipments to Postal Service retail units and include year-end balances at the Stamp Distribution Offices when estimating the stamp printing requirement for the Bureau of Engraving and Printing. In addition, we recommended Postal Service management establish policies and procedures at the Dulles Stamp Services Center that ensure excess stamps are returned to inventory for redistribution. Management agreed with our recommendations and corrective actions planned by management meet the intent of our recommendations. Management's comments and our evaluation of these comments are included in the report.

The OIG considers recommendations 1 through 4 significant and, therefore, requires OIG concurrence before closure. Consequently, OIG requests written confirmation when corrective actions are completed. These recommendations should not be closed in the follow-up tracking system until OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff during the audit. If you have any questions, please contact, Larry Chisley, director, at (703) 248-2100, or me, at (703) 248-2300.

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for eBusiness

Attachment

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TABLE OF CONTENTS

Executive Summary	i
Part I	
Introduction	1
Background	1
Objectives, Scope, and Methodology	1
Prior Audit Coverage	2
Part II	
Audit Results	3
Stamp Printing Quantities	3
Recommendations	5
Management's Comments	5
Evaluation of Management's Comments	5
Stamps Processed for Destruction	6
Recommendations	7
Management's Comments	7
Evaluation of Management's Comments	7
Appendix A. Forecasted Excess Stamps	9
Appendix B. Weighted Average Printing Cost of Stamps Processed for Destruction	11
Appendix C. Management Comments	12
Appendix D. Revised Management Comments	17

EXECUTIVE SUMMARY

Introduction

The Office of Inspector General (OIG) initiated this audit to determine whether the Postal Service printed the appropriate quantity of stamps to meet customer needs. This is one of two reports we plan to issue on stamp printing quantities, and focuses on quantities printed by the Bureau of Engraving and Printing and stamps destroyed at the Dulles Stamp Services Center. Our objectives were to determine (1) whether stamp quantities were appropriate to meet customer needs, and (2) whether saleable stamps were being destroyed.

Results in Brief

The audit revealed that quantities scheduled for printing at the Bureau of Engraving and Printing will exceed demand by about 5.2 billion and 3.5 billion for fiscal years (FYs) 2001 and 2002, respectively. Stamp printing quantities were overstated because the printer's guaranteed stamp printing requirement was not based on forecasted customer demand. Postal Service management could reduce the FY 2002 stamp printing costs by \$10 million.

In addition, we identified approximately 462 million saleable¹ stamps returned as excess and processed for destruction at the Dulles Stamp Services Center during FY 2000. Stamps returned to the Dulles Stamp Services Center are destroyed regardless of the reasons why they were returned. However, we believe stamps identified and returned as excess should be returned to inventory for redistribution. Saleable stamps destroyed at the Dulles Stamp Services Center during FY 2000 had an estimated printing cost of \$1.4 million and a retail value of about \$99.4 million.

Summary of Recommendations

We recommended that the manager, Stamp Acquisition and Distribution reduce the FY 2002 overall stamp quantities by approximately 3.5 billion stamps. Also, the manager, Stamp Acquisition and Distribution, should establish future stamp printing requirements based on forecasted shipments to

¹ Saleable stamps are stamps that have not been withdrawn from sale at Postal Service retail units, redeemed by the customer, or damaged.

Postal Service retail units and include year-end balances at the Stamp Distribution Offices when estimating the stamp printing requirement at the Bureau of Engraving and Printing.

In addition, the manager, Stamp Distribution, should establish policies and procedures at the Dulles Stamp Services Center that ensure excess stamps are returned to inventory for redistribution.

Finally, we recommended that the manager, Stamp Distribution, record stamp item numbers, reason codes, and quantities of stamps processed for destruction.

Summary of Management's Comments

Management agreed with our findings and recommendations. Management will reduce the overall FY 2002 stamp quantities by approximately 3.5 billion stamps. Stamp Acquisition and Distribution instituted a system to forecast future stamp quantities by analyzing historical shipment data and First-Class Mail volume variances. They have implemented measures to ensure that excess saleable stamps will be returned to inventory for redistribution and will test the effectiveness of recording stamps processed for destruction by stamp item numbers, reason codes, and quantities at the Dulles Stamp Services Center. Management's comments, in their entirety, are included in Appendices C and D of this report.

Overall Evaluation of Management's Comments

Management's comments were responsive to our findings and recommendations. The overall reduction in the FY 2002 Stamp Program will minimize the amount of excess stamps to be printed by the Bureau of Engraving and Printing during FY 2002. Also, the implementation of a forecasting system based on historical shipment data and First-Class Mail volume variances will assist management in identifying their stamp printing format² requirements for FY 2002.

Management's planned actions will help ensure excess saleable stamps are returned to inventory and that stamp

² Formats are defined as types and quantities of stamps, which include gummed, pressure sensitive adhesive, coils, booklets, and sheets.

item numbers, reason codes, and quantities will be recorded when stamps are processed for destruction at the Dulles Stamp Services Center.

INTRODUCTION

Background

The Postal Service purchases an average of 40 billion First-Class postage stamps annually through printing contracts, at an average cost of \$125 million. The Bureau of Engraving and Printing printed approximately 17 billion of the 40 billion First-Class postage stamps in fiscal years (FYs) 1999 and 2000.³ The Bureau of Engraving and Printing prints definitive stamps in large quantities. Definitive stamps are regular postage stamps that are issued in unlimited quantities and remain on sale for an indefinite period.

The Stamp Acquisition and Distribution Office establishes stamp printing quantities by format and the distribution of stamps to Postal Service retail units. Personnel from the Stamp Acquisition and Distribution Office determine the quantity of stamps to be printed at the Bureau of Engraving and Printing by identifying past printing requirements and monitoring stamp requisitions from Postal Service retail units, Stamp Distribution Offices, and Stamp Services Centers.

The inventory system at the Stamp Services Centers has the capability to track stamp returns from Postal Service retail units and destruction quantities by stamp item number. Postal Service retail units return excess, damaged, and obsolete stamp stock to the Stamp Services Centers using Accountable Items Returned to Stamp Distribution Network forms.⁴

Objectives, Scope, and Methodology

Our audit objectives were to determine (1) whether the Postal Service printed an appropriate quantity of stamps to meet anticipated customer needs, and (2) whether saleable stamps were being destroyed.

In reviewing whether the Postal Service printed the appropriate quantity of stamps, we interviewed Postal Service officials in headquarters Stamp Acquisition and

³ Four private sector printers, Ashton Potter, Avery Dennison Security Printing division, Banknote Corporation of America, and Sennett Security Products produce the remaining First-Class postage stamps for the Postal Service.

⁴Accountable Items Returned to Stamp Distribution Network forms contain pertinent data such as the reason codes that describe the purpose of the return and the stamp item number that identifies the description, format, and denomination of stamps. The reason codes for the return of stamps are: (1) removed from sale; (2) redeemed by customer; (3) damaged; (4) overstock (excess); (5) ordered in error; (6) recalled; (7) redeemed United States international reply coupon; (8) exchanged foreign international reply coupons, and (9) other.

Distribution, and officials at the Bureau of Engraving and Printing.

We obtained National Item Inventory Reports to assess the ending inventory balances at the Stamp Distribution Offices and the Stamp Services Centers for FYs 1998, 1999, and 2000. We also obtained the Stamp Stock Status Reports from the Bureau of Engraving and Printing to analyze printing quantities of stamps produced during FYs 1999 and 2000.

To evaluate the stamp destruction process, we reviewed and analyzed the Accountable Items Returned to Stamp Distribution Network forms for FY 2000 at the Dulles Stamp Services Center.

We researched Postal Bulletins from 1995 to 2000 to compile a listing of stamps withdrawn from sale at Postal Service retail units, philatelic centers, and the Stamp Fulfillment Center. We obtained compilations of FY 1998 through 2000 stamp printing invoices from Stamp Acquisition officials to compute the average printing costs for saleable postage stock recorded for destruction. We also obtained Destruction Stock Reports from the Bureau of Engraving and Printing to determine the quantities of 32-cent stamps destroyed at the Bureau of Engraving and Printing during FY 1999.

This audit was conducted from May 2000 through September 2001 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 recommendations 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 audit.

AUDIT RESULTS

Stamp Printing Quantities

The FY 2002 printing schedule for the Bureau of Engraving and Printing requires the Postal Service to purchase 12 billion stamps at a cost of approximately \$ 39.6 million. However, the printing requirement will exceed demand by 3.5 billion stamps. The FY 2001 printing requirement of 15 billion stamps exceeded demand by 5.2 billion stamps. An interagency agreement between the Postal Service and the Bureau of Engraving and Printing requires the Postal Service to purchase a predetermined number of stamps each year ending in FY 2005.

The following chart represents FYs 2001 and 2002 printing requirements at the Bureau of Engraving and Printing.

Forecasted Excess Stamps at the Bureau of Engraving and Printing (in billions)		
	FY 2001	FY 2002
Stamp Printing Volume	15.2	12.0
Excluding 33-cent Stamps Printed	(1.8)	0.0
Adjusted Stamp Printing Volume	13.4	12.0
Forecasted Printing Requirement*	(8.2)	(8.5)
Excess Stamps	5.2	3.5
*Forecasted Printing Requirement includes Forecasted Demand less Reduction in Beginning Inventory. See Appendix A for Details.		

Stamp printing quantities were overstated because the printer's stamp printing requirement was not based on forecasted demand from Postal Service retail units. To determine the stamp quantities that were needed for FY 2001 we identified the average number of stamps that were ordered by Postal Service retail units for FYs 1999 and 2000. We also included the Postal Service forecasts of First-Class Mail volume increases of 2.5 percent and .9 percent for FYs 2000 and 2001, and increases due to the anticipated rate change.

As a result, we estimated the Postal Service only needed to print about 8.2 billion stamps for FY 2001. However, the Bureau of Engraving and Printing was scheduled to print about 13.4 billion⁵ stamps for FY 2001. Consequently, the Postal Service purchased an excess of approximately 5.2 billion stamps from the Bureau of Engraving and Printing in FY 2001.

We estimate the FY 2002 stamp printing requirement for the Bureau of Engraving and Printing to be approximately 6.3 billion stamps. This number is based on the forecasted number of stamps ordered by Postal Service units during FY 2001, forecasted number of stamps that will be on hand at the beginning of FY 2002 and the forecasted increases in First-Class Mail volume.

Postal management requested that we include in our calculations a forecasted year-end inventory balance at the Stamp Distribution Offices that would supply postal retail facilities for 3 months into FY 2003 for an expected rate change. We agreed upon a 2.2 billion stamps year-end inventory that would be needed to supply Postal Service retail facilities for a transition into a new rate-change. We recomputed the FY 2002 stamp printing requirement for the Bureau of Engraving and Printing to be approximately 8.5 billion stamps (6.3 billion stamps plus the 2.2 billion stamps)

The Postal Service cannot reduce its printing requirement at the Bureau of Engraving and Printing for FY 2002 because of its interagency agreement with the Bureau of Engraving and Printing. The Postal Service has more flexibility to reduce stamps quantities printed by private sector printers because these printers have lower minimum printing requirements. With a rate change expected to occur in FY 2003, the Postal Service could curtail quantities of the current rate stamps for the production of new rate stamps. Therefore, the Postal Service can reduce its overall FY 2002 stamp printing program by 3.5 billion stamps for a savings of approximately \$10 million.

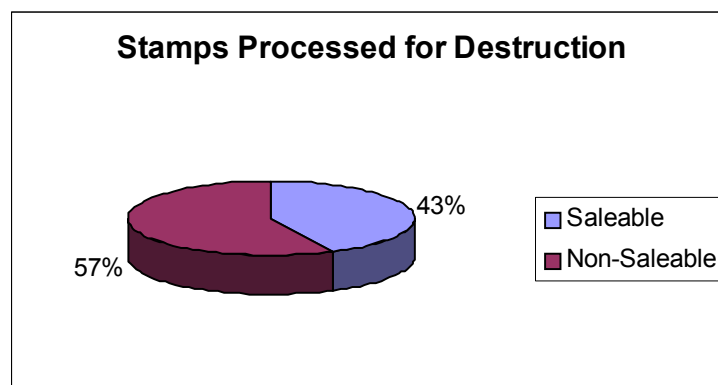
⁵ The figure does not include 1.8 billion 33-cent stamps that were printed in FY 2001.

Recommendation	We recommend the manager, Stamp Acquisition and Distribution: 1. Reduce the FY 2002 overall stamp program by approximately 3.5 billion stamps.
Management's Comments	Management agreed with our recommendation to reduce the overall FY 2002 stamp program including quantities of both the Bureau of Engraving and Printing and the private sector printers.
Evaluation of Management's Comments	Management's comments were responsive and corrective actions planned by management meet the intent of our recommendation.
Recommendation	2. Base future stamp printing quantities on forecasted stamp shipments to Postal Service retail units, forecasted increases or decreases in mail volume, and forecasted year-end inventory balances at the Stamp Distribution Offices, Stamp Services Centers, and the Bureau of Engraving and Printing.
Management's Comments	Management agreed with our recommendation and stated they have instituted a forecasting system based on this principle.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation and management has implemented a system to examine production and inventory data.

Stamps Processed for Destruction

Approximately 462 million excess saleable⁶ stamps with a retail value of about \$99.4 million were destroyed at the Dulles Stamp Services Center during FY 2000. Printing costs for stamps destroyed at the Dulles Stamp Services Center totaled approximately \$1.4 million. Stamps are returned by Postal Service retail units for a variety of reasons, including stamps being withdrawn from sale, damaged, or excess saleable stock. Excess stamp stock destroyed at the Dulles Stamp Services Center accounted for 43 percent of stamps returned in FY 2000.

The following table illustrates the percentage of saleable stamps processed for destruction at the Dulles Stamp Services Center in FY 2000.



Contrary to Postal Service procedures, stamps returned to the Dulles Stamp Services Center⁷ were processed for destruction, regardless of the reasons they are returned. Handbook F-1, Post Office Accounting Procedures, Section 437.1 states that offices within the Stamp Distribution Office Service area may return saleable stock for redistribution and that the Stamp Distribution Office officials must enter the saleable stock in its inventory system. However, when saleable stamps were returned to the Dulles Stamp Service Center, officials only recorded the dollar value of the returned saleable stamps as redeemed stamp stock. Stamps were then boxed and stored on pallets until they were destroyed. Saleable stamps returned

⁶ Saleable stamps are stamps that have not been withdrawn from sale at Postal Service retail units, redeemed by customers, or damaged.

⁷ We calculated an average printing cost of \$2.95 per thousand stamps. See Appendix B for additional information.

as excess should be redistributed to fill stamp orders from Postal Service retail units. Redistributed excess stamps would assist in reducing the number of stamps needed and printing costs. By destroying all of the saleable stamps returned to the Dulles Stamp Service Center the Postal Service unnecessarily eliminated valuable stamp inventory, which cost \$1.4 million to produce. As a result, we consider the \$1.4 million as unrecoverable costs that could have been avoided.

In addition, individual stamp item numbers are not recorded when stamps are processed for destruction. As a result, Postal Service officials cannot easily identify the types of stamps that are being returned and the Postal Service retail units that are returning the stamps. The recording of individual stamp item numbers would allow Postal Service officials to identify the type of stamps that were being returned. Officials would then have another indicator that would help identify potential excess stamp stock and identify the type of stamps that were not selling and geographical areas affected.

Recommendation	We recommend the manager, Stamp Distribution, should: 3. Establish policies to ensure excess saleable stamps are returned to inventory for redistribution in accordance with Handbook F-1, <u>Post Office Accounting Procedures</u> .
Management's Comments	Management agreed with our recommendation, and stated that during the third quarter of FY 2000, the Dulles, Virginia Stamp Service Center began enforcing the established policy that excess saleable stamps be returned to inventory and redistributed as requested by postal retail facilities.
Evaluation of Management's Comments	Management's comments are responsive to our recommendation. Management will start enforcing existing policy and ensure excess saleable stamps are returned to inventory.
Recommendation	4. Record stamp item numbers, reason codes, and quantities of stamps processed for destruction.

**Management's
Comments**

Management agreed with our recommendation and stated that a computer system, Stamp Service System, captured the data we recommended, but has not been implemented at three sites, including Dulles, Virginia. However, management stated they would incorporate the recording of stamp item numbers, reason codes, and quantities of stamps when stamps are processed for destruction at the Dulles Stamp Service Center in FY 2002 and will evaluate the impact of this process.

**Evaluation of
Management's
Comments**

Management's comments are responsive to our recommendation. Management will incorporate the recording of stamp item numbers, reason codes, and quantities of stamps when stamps are processed for destruction at the Dulles Stamp Service Center in FY 2002 and will evaluate the impact of this process.

APPENDIX A

FORECASTED EXCESS STAMPS

Of the 15.2 billion stamps scheduled to be printed at the Bureau of Engraving and Printing in FY 2001, we reduced the scheduled quantity by the 1.8 billion 33-cent stamps that were printed prior to the rate-change that occurred January 7, 2001. We then compared the planned printing of the 13.4 billion stamps to our forecast of FY 2001 requirements, to determine the effect of any excess printing on the required printing quantities for FY 2002.

We calculated that 8.2 billion stamps, rather than 13.4 billion stamps, was the required printing quantity of 34-cent, bulk-mail, nondenominated and 1-cent stamps for FY 2001. Our methodology, which was based on an analysis of orders of similar formats in FYs 1999 and 2000, uses the average quantities over a 2-year period. The methodology is summarized below:

- The FY 1999 stamp orders totaling 5.4 billion stamps were divided by the number of months that each stamp design was issued during the fiscal year. This gave an average monthly order total of 849 million stamps. We inflated this quantity to accommodate FY 2001 requirements using the mail volume growth factors provided by the Postal Service: 1.025 and 1.009 for FYs 1999 and 2000 respectively. This inflation resulted in a printing of 878 million stamps per month using an FY 1999 baseline.
- The FY 2000 stamp orders were similarly adjusted to a monthly basis and inflated, by the 1.009 multiplier only, to FY 2001 quantities. That calculation resulted in a total of 904 million monthly stamp orders using an FY 2000 baseline.
- For our FY 2001 forecast, we used the arithmetic average of the monthly FY 1999 result and the monthly FY 2000 result. We calculated the annual quantity for FY 2001 by multiplying the monthly average quantity for each stamp type by the number of months in FY 2001 that each type would be ordered. The calculation resulted in an FY 2001 forecast of 6.6 billion stamps.
- We did not alter the number of nondenominated 34-cent stamps and 1-cent stamps because we assumed that all 2.7 billion such stamps would be shipped to Postal Service retail units to accommodate the transition to the rate change.
- The resulting FY 2001 forecast order of 9.4 billion stamps is composed of 6.6 billion 34-cent and bulk mail stamps plus 2.7 billion of nondenominated 34-cent and 1-cent stamps.

- We then reduced the 9.4 billion FY 2001 forecast by 1.2 billion stamps based on the beginning stamp inventory balances of FY 2001. We, therefore, calculate a required printing quantity for FY 2001 of 8.2 billion stamps.

The 13.4 billion postage stamps exceeded the above calculated requirement for FY 2001 by 5.2 billion stamps. Since the production schedule for FY 2001 cannot be reduced due to terms in the interagency agreement, we used the forecasts for FY 2001 to determine required printing quantities for FY 2002. The interagency agreement between the Bureau of Engraving and Printing and the Postal Service currently states that the minimum printing requirement for FY 2002 is 12 billion stamps.

We calculated that 8.5 billion stamps would be the required printing quantity for FY 2002, as follows:

- We assumed that all stamp formats, except the nondenominated stamp formats, would be reprinted for FY 2002. We allocated the 12 billion required minimum printing requirement based on the quantities that were scheduled for printing for FY 2001.
- To account for mail volume growth, we applied the Postal Service volume growth factor to the FY 2001 quantities. Therefore, the FY 2002 forecast demand of 11.5 billion stamps is equal to the monthly stamp orders of FY 2001 multiplied by 12 months and then multiplied by 1.015 (1.5 percent) mail volume growth for FY 2001.
- We reduced the FY 2002 forecast requirement of 11.5 billion stamps by the calculated beginning inventory balance of 5.2 billion stamps to forecast a required printing quantity for FY 2002 of 6.3 billion stamps.
- We computed an ending inventory balance of 2.2 billion stamps at the Stamp Distribution Office, which is based on 3 months of forecasted usage of the 33-cent 100 coil format stamps.
- Finally, we computed a required printing quantity for FY 2002 of 8.5 billion stamps (6.3 billion stamps plus 2.2 billion).

As a result, the FY 2002 minimum printing requirement at the Bureau of Engraving and Printing, 12 billion stamps, would exceed new printing requirements by 3.5 billion stamps.

APPENDIX B

WEIGHTED AVERAGE PRINTING COST OF STAMPS PROCESSED FOR DESTRUCTION

We computed an average printing cost of \$2.85 for coil format⁸ stamps and an average printing cost of \$3.83 for noncoil format stamps, based on the average printing costs of stamps printed in FYs 1998, 1999, and 2000. We calculated an overall weighted average printing cost of \$2.95. The overall weighted average printing cost is the sum of the following:

- The result of multiplying the average printing cost for coil format stamps by the percentage of stamps returned that were of the coil format.
- The result of multiplying the average printing cost for noncoil format stamps by the percentage of stamps returned that were of the noncoil format.

Stamp Format Quantity	Stamp Quantity	Fraction of Total Stamp Quantity	Average Printing Cost (per thousand stamps)	Weighted Average Printing Cost*	Total Printing Cost
Noncoil	45,929,672	0.10	\$3.83	\$0.38	\$175,911
Coil	416,592,000	0.90	\$2.85	\$2.57	\$1,187,287
Total	462,521,672			\$2.95	\$1,363,198

*Figures are the result of multiplying Average Printing Cost and Fraction of Total Stamp Quantity

⁸ Stamps that are packaged into rolls or spirals are called coil formats.

APPENDIX C. MANAGEMENT'S COMMENTS

STAMP SERVICES



July 24, 2001

Debra S. Ritt
Assistant Inspector General
For Business Operations
Office of the Inspector General

SUBJECT: Response to Draft Audit Report – Stamp Printing Quantities
(Report Number MK-AR-01-DRAFT)

Attached are the responses to the recommendations resulting from the audit performed by the Office of the Inspector General focusing on the Postal Service's stamp printing quantities (Project Number 00RA055RG000). The responses are provided in the order of the recommendations as stated on pages 4 and 6 of the draft report.

Recommendation 1:

We recommend the manager, Stamp Acquisition and Distribution, in coordination with the manager, headquarters Purchasing, should:

Reduce the FY 2002 minimum stamp printing requirement from the Bureau of Engraving and Printing agreement by approximately 5.7 billion stamps.

We do not concur with this recommendation.

There are several factors that drive this position as listed below.

1. It is in the best interest of the Postal Service (USPS) to procure the full allocation of stamps to be printed by the Bureau of Engraving and Printing (BEP), based on the fixed cost associated with the interagency agreement between the BEP and USPS.
2. An reduction of 5.7 billion stamps from the BEP stamp allocation would decrease the USPS flexibility to respond to inventory needs and any unexpected events such as a rate change or any change in customer purchase and/or use behavior(s).
3. Stamp allocations in the stamp program are assigned based on pricing and on the demonstrated capacity and expertise of our contracted suppliers. Private suppliers currently do not have sufficient equipment capacity to efficiently provide the coil program as assigned to the BEP. It is expected that the private suppliers will have this expertise within the next two to three years.
4. Political implications and the maturing of private sector capabilities has dictated a gradual shift of stamps supplied by the BEP over to private printers, from 90% to 30% of the total stamp program in 2002. This transition has been accomplished through our development of our Multiprint contracts and renegotiations of the Interagency Agreement between USPS and BEP.

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It must be emphasized that the reduction in the allocation for the BEP does not represent mirrored saving to the USPS. Since these costs are fixed, it is in the best interest of the USPS to maximize capacity benefits of BEP's allocation and manage it within inventory needs. Included in these fixed costs are more elements than merely the printing of the stamps. They also include the cost of:

- Printing materials and paper;
- Equipment (printing presses and finishing equipment);
- Approximately 200 employee positions associated with stamp production at the BEP; and,
- Storage and distribution of stamps at the BEP for initial and re-supply to stamp distribution offices (SDOs) and many of the post offices nationwide who are not able to order or maintain stamps in bulk supply.

Inventories are closely monitored for the BEP, private stamp suppliers and the SDOs. This is necessary, as there must be a balance of requirements with production and supply. A complete analysis of the quantities available at the SDOs and those being planned or produced must be done to ensure product to the customer, and no one part of this chain can be separately considered as stamp format also plays a part in this process. As an example, the 2002 program that was provided to the Bureau in April of this year in accordance with the agreement provides flexibility in how the core product (self-adhesive coils of 100) will be produced. We are anticipating a rate case filing either later this year or early next. If it appears that the inventory levels of the "Flowers" and "Statue of Liberty" self-adhesive coils of 100 are sufficient to meet customer needs and inventory demand; we will switch the BEP production to the new rate change stamps.

Since the focus is on the BEP let's discuss the current monitoring of the "Statue of Liberty" coils of 100, which are produced by the BEP, for an 18-month period, beginning with Fiscal Year (FY) 2001 as an example. Monthly usage of the coils is approximately 760 million stamps per month. Allocations for this coil, including non-denominated and denominated stamps, were 10 billion stamps (non-denominated stamps to accommodate the January 2001 rate change). Field usage through automatic distribution and requisitions filled to post offices nationwide have been:

<u>Time Frame</u>	<u>Field Usage Quantity</u>
September – March 2001	3.822 billion stamps
April	925 million
May	388 million
June	571 million
<u>July (1/2 month)</u>	<u>711 million</u>
Total	6.417 billion

On the other hand, production at the BEP has been as follows:

<u>Time Frame</u>	<u>BEP Production Quantity</u>
September – March 12, 2001	3.710 billion stamps
April 16	1.289 billion
May 14	922 million
June 18	965 million
<u>July 16, 2001</u>	<u>891 million</u>
Total	7.777 billion

An analysis of both of these listings shows use (draw down) versus production and a clear balance between the two. In addition, adding the FY 2002 projection of 8.5 billion stamps to the remaining 3,580 billion stamps in the FY 2001 program provides the same balance through January 2003, with roughly an 11-month usage. A necessary point at this juncture is that using the proposed reduction assumes an exact match of production to use (zero-based inventory) at all SDOs at the end of this period. This assumption is not considered good business sense, as some inventory must be on hand to re-supply 40,000 post offices with these coils, both expectedly and unexpectedly.

The remainder of the program for the BEP includes the large coils (3,000- and 10,000-stamp coils for the business customer and vending equipment, which are ordered only as needed to satisfy customer needs. With the exception of the larger 34-cent coils, these coils are principally non-denominated and are produced only as inventory levels dictate.

Also of note in this instance is that there are political implications involved with the provisions of the interagency agreement, and that the quantities included in that agreement were arrived at giving consideration to key elements of the stamp program. First, the primary expertise of the BEP presently is the production of stamp coils in various sizes. This forces the consideration of the readiness of the private sector to assume the production of the stamps included in the BEP's allocation, as they are not equipped to provide the coils needed to supply our customer needs. In addition, this will require investments that the private sector must make to begin to provide these coils as well as time and experience in doing the work involved in this production process. A second consideration is the storage and replenishment operations included in the BEP's costs and the lack of space in field sites to assume the storage of these stamps/coils to the field. Third and finally, we had to consider the impact on the BEP and its unions, as work is transitioned to the private sector.

Recommendation 2:

Base future stamp printing quantities on forecasted stamp shipments to Postal Service retail units, forecasted increases or decreases in mail volume, and forecasted year-end inventory balances at the Stamp Distribution offices, Stamp Services centers and the Bureau of Engraving and Printing.

We concur and have already instituted forecasting based on this principle. It must be understood that there are still two critical elements under development that will further assist in the forecasting methodology, and they are the full implementation of the Stamp Services System (SSS) and the POS system. SSS will afford us to track inventory by item number from entry into the system

through the destruction process, affording knowledge of the stamps' performance. With the POS system we will be able to capture sales information on each individual stamp issue. This will provide us with the necessary data to more accurately forecast than already exists.

Using the current inventory information, we have been able to examine production and inventory data as stated in your recommendation and effectively eliminate or reduce stamp issues and quantities based on inventory draw-down. The current FY 2001 stamp allocation reduced overall quantities by 2.1 billion stamps from FY 1999 in formats that no longer meet customer demand.

Recommendation 3:

Establish policies to ensure excess saleable stamps are returned to inventory for redistribution in accordance with Handbook F-1, Post Office Accounting Procedures.

We agree. During Quarter 3, FY 2000, the Dulles, Virginia stamp service center (SSC) began enforcing the established policy that offices must obtain approval prior to returning excess saleable stock. Additionally, offices are not allowed to co-mingle saleable stock with off-sale stock returned during scheduled, return cycles.

The SSC identifies and returns stock not meeting these criteria to the originating office for correction and resubmission during the next return cycle. Properly received excess saleable stock will continue to be identified as such, returned to inventory, and redistributed as requested by offices.

Recommendation 4:

Record stamp item numbers, reason codes, and quantities, of stamps processed for destruction.

We agree. Presently, stamp distribution offices (SDOs) nationwide capture data utilizing the STAMPS system. The primary function of this system is to track accountability for electronic transfer to postmaster account files and the general ledger. This system cannot accommodate the tracking of these data.

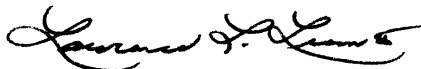
A new computer system, Stamp Service System (SSS), is designed to accommodate inventory management data. This system will afford the capture of the data requested and provide the detail sited. SSS is presently utilized at only three sites, including Dulles, Virginia. Since this is such a small portion of the national data and/or sites, these three sites have not implemented this process. This decision was based on the fact that such a small part of the total data needed to project national trends would be available and that it would not provide a representative sample that would be of any significance at this time. The additional 102 sites nationwide require SSS to meet the above recommendation and thereby achieve an accurate assessment of returned stock. However, the Dulles, Virginia SSC is planning to incorporate this process in its operating procedures in Fiscal Year 2002, to evaluate local significance.

Summary

As a final note in responding to the recommendations, we re-emphasize that we feel strongly that assessing production and inventory requirements under the current rate-making process must be considered. In producing stamps for customer needs it is essential that a proper level of inventory be maintained to meet all customer demand throughout our 40,000 post offices and additional thousands of consignment outlets.

Unlike other organizations who can establish new rates in advance and allow for the supporting units to change inventory accordingly, we cannot. Taking the last rate case as an example, Stamp Services could not assume that the rates would be recommended by the Postal Rate Commission (PRC) and approved by the Board of Governors (BOG) until December 2000, one month before the scheduled implementation. Consequently, without reformation of the rate-making process, we were forced to maintain inventory levels that allowed us to provide product to our customers should our BOG reject or defer the rate implementation further than January. This was the case in 1998 when the PRC recommended the rates in late May but the BOG deferred implementation until January 1999.

Thank you for the opportunity to respond to your recommendations. Should there be a need for any additional information, please contact me at (202) 268-2325.



Lawrence L. Lum, II
Manager
Stamp Acquisition
and Distribution

APPENDIX D: REVISED MANAGEMENT'S COMMENTS DATED
AUGUST 21, 2001

STAMP SERVICES



August 21, 2001

Ms. Debra S. Ritt
Assistant Inspector General for Business Operations
Office of Inspector General
1735 North Lynn Street, Room 10000
Arlington, VA 22209-2020

Dear Ms. Ritt:

This is in response to Draft Audit Report – Stamp Printing Quantities (Report Number MK-AR-01-DRAFT). We have had further discussions with members of your staff concerning our July 24 response to Recommendation 1 of the above referenced report. Our position that we should not reduce the Bureau of Engraving and Printing's (BEP) FY 2002 stamp allocation has not changed due to the reasons stated in our July 24 response. However, we do concur with your staff's verbal recommendation to make a corresponding reduction in the private sector allocations of stamp coils and other issues that could be produced by the BEP.

As you know, the BEP's current production strength is in the area of stamp coils and the majority of our stamp coil program has been allocated to the BEP for that reason. However, as we have been decreasing the BEP's yearly allocations, we have been gradually increasing the number of coil products being produced by our private sector printers. This gradual shifting of coils to the private printers is in keeping with our strategy to fully mature the capabilities of the private sector so that we can transition the stamp program to them without any interruptions in production.

Our preliminary requirements for FY 2002 call for approximately 3.3 billion stamps in coils being assigned to the private sector. If necessary, we will shift these 3.3 billion coil stamps to the BEP. Based on current projections the private sector may receive approximately 26 billion stamps. This would reduce their allocation to 22.7 billion stamps, and only 16 billion stamps are necessary to fulfill contractual obligations among the private printers.

It is also highly possible that there will be a rate filing this fall which may require production in FY 2002 in preparation for a rate change as early as August or September 2002. As with previous rate changes, this will require producing a limited number of non-denominated stamps for readiness within a 30-day announcement of implementation. This would more than likely require an additional number of coils to be produced. For the 2001 rate filing approximately 1.5 billion non-denominated stamps in coils were produced by the BEP and 1.0 billion non-denominated stamps in coil formats were produced by the private sector. All could be allocated to the BEP to meet their 12 billion minimum.

However, we are not in a position at this time to identify the specific coil stamps being allocated between the BEP and the private sector, as we must await the decision regarding a possible rate filing. Once this filing announcement is made, we will review the program requirements along with the possible timing of implementation and develop our program requirements in anticipation of this change. We should be able to complete this process by January 2002.

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We fully agree that there is room for reduction in our stamp production quantities and are continually striving to reduce both the definitive and commemorative program volumes every year. In conjunction with this effort, we established a tracking usage program two years ago, which enabled us to identify the quantities required to fulfill the rate implementation last January. We were able to do this and minimize inventory carryover of the non-denominated stamps. In addition, by carefully reviewing the usage of the various formats through the last rate cycle, we have been able to reduce and eliminate approximately 5 billion coil stamps from production quantities previously produced by the BEP in formats that have shown limited customer demand. We agree that there is still room for additional reductions without jeopardizing necessary inventory maintenance levels.

Thank you for your assistance with our efforts in maintaining the world's finest stamp program at the greatest economic value.



Lawrence L. Lum, II
Manager
Stamp Acquisition
And Distribution

cc: Ms. Willhite
Ms. Caggiano

**REVISED MANAGEMENT'S COMMENTS
DATED SEPTEMBER 24, 2001**

STAMP SERVICES



September 24, 2001

Debra S. Ritt
Assistant Inspector General
For Business Operations
Office of the Inspector General

SUBJECT: Response to Draft Audit Report – Stamp Printing Quantities
(Report Number MK-AR-01-DRAFT)

As regards our memorandums of July 24, 2001 and August 21, 2001 regarding the above referenced report, please be advised that we have agreed to reduce the overall 2002 stamp program. This includes production quantities of both the Bureau of Engraving and Printing and the private sector printers by a combined reduction of 3.5 billion stamps. This should result in a net cost reduction in the amount of approximately 9.8 – 10 million dollars, dependent on the cost per thousand-unit price at the end of FY 2002.

A handwritten signature in black ink, appearing to read "Lawrence L. Lum, II".

Lawrence L. Lum, II
Manager
Stamp Acquisition & Distribution