



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

Bad Check Prevention and Collection

Audit Report

January 10, 2012

Report Number FI-AR-12-002



HIGHLIGHTS

January 10, 2012

Bad Check Prevention and Collection

Report Number FI-AR-12-002

IMPACT ON:

Bad check operations at the Accounts Reconciliation Branch and Finance Branch in Eagan, MN, and at the National Customer Service Center in Memphis, TN.

WHY THE OIG DID THE AUDIT:

Our objectives were to determine whether U.S. Postal Service policies and procedures to prevent and collect bad checks were effective and efficient and whether the process for collecting bad checks was cost effective.

WHAT THE OIG FOUND:

Postal Service's policies and procedures to prevent and collect bad checks were effective and efficient. The Postal Service collected about 69 percent of bad check debt, and bad checks represented 0.14 percent of retail check payments, which was over seven times better than the industry average of 1 percent. In addition, the collection process for bad checks was cost effective, and management has decreased staffing to process and collect bad checks concurrently with bad check volume. However, there is additional opportunity to decrease bad check costs by increasing the bad check service fee to the national retail median.

WHAT THE OIG RECOMMENDED:

The U.S. Postal Service Office of Inspector General (OIG) recommended the vice president, Controller, increase the bad check service fee to the national retail median of \$30.

WHAT MANAGEMENT SAID:

Management agrees with the recommendation to increase the bad check fee and monetary impact of \$577,115. However, management disagrees that the fee increase will reduce costs. Instead, they view the increased fee as an offset to the cost of bad check acceptance. In addition, management does not believe the increased bad check fee will reduce the number of bad checks. The bad check fee increase will take effect by June 30, 2012.

AUDITORS' COMMENTS:

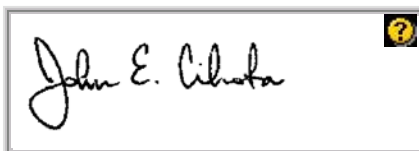
The OIG considers management's comments responsive to the recommendations, and the corrective actions should resolve the issues identified in the report.

[Link to review the entire report](#)



January 10, 2012

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

A rectangular box containing a handwritten signature in black ink 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: Audit Report – Bad Check Prevention and Collection
(Report Number FI-AR-12-002)

This report presents the results of our audit of the U.S. Postal Service's bad check prevention and collection (Project Number 11BD007FF000).

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
Ellis A. Burgoyne
Pritha Mehra
Corporate Audit and Response Management

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Introduction

This report presents the results of our audit of the U.S. Postal Service's bad check prevention and collection process (Project Number 11BD007FF000). This self-initiated audit addresses financial risk. Our audit objectives were to determine whether Postal Service policies and procedures to prevent and collect bad checks were effective and efficient and whether the process in place for collecting bad checks was cost effective. See [Appendix A](#) for additional information about this audit.

Postal Service customers can pay for products and services using cash, debit/credit cards, money orders, and checks. While paying by check is convenient for customers, there is a risk associated with check acceptance. Occasionally, the account on which the check is drawn has nonsufficient funds available, resulting in a delay or loss of funds transferred to Postal Service accounts. The Postal Service receives more than \$20 million in bad checks annually. To help prevent bad check acceptance and collect bad check funds, the Postal Service automated the manual bad check identification process at Point of Service (POS) post offices¹ in March 2009.² The Postal Service and its contracted collection agency record all bad checks and collection results in the Return Check Management System (RCMS). Between fiscal years (FYs) 2008 and 2011, the number of bad checks received declined significantly due to the decrease in customer check use and the automation of the bad check identification process in the POS system. See Chart 1 in [Appendix A](#) for details of the decline.

Conclusion

The Postal Service's policies and procedures to prevent and collect bad checks were effective and efficient. In FY 2011, the Postal Service collected about 69 percent of bad check debt, and bad checks represented 0.14 percent of retail check payments, which was over seven times better than the industry average of 1 percent. In addition, we determined the collection process for bad checks was cost effective, and that staffing to process and collect bad checks has decreased concurrently with bad check volume. However, there is additional opportunity to decrease bad check costs by increasing the bad check service fee to the national retail median.

Bad Check Service Fees

The Postal Service charges customers a \$25 bad check fee while other major retailers have increased their bad check fees to \$30. According to management, each state/jurisdiction has its own laws and regulations for calculating bad check damages;³ consequently, the Postal Service elected to establish a standardized bad check fee of

¹ Post offices use the POS hardware and software system to conduct sales transactions during the Post Office checkout process.

² Effective March 7, 2009, management enhanced customer check acceptance functionality in the POS systems to include the Bad Check List file.

³ Depending on jurisdiction, bad check writers can be assessed bank charges, interest, attorney fees, and other damages.

\$25. According to a study released in August 2010,⁴ national retail merchants have raised the median bad check fee by 20 percent from 2009. In addition, Postal Service management stated the fee has remained at \$25 because that is the amount in the collection agency contract. The current collection agency's contract is set to expire in February 2012. Increasing the bad check service fee nationally in conformance with retail industry standards could have reduced costs by about \$185,000 annually in FY 2010 and 2011. In addition, raising bad check fees to \$30 could reduce costs by an estimated \$100,000 annually over the next 2 years. See [Appendix B](#) for details on monetary impact.

Recommendation

We recommend the vice president, Controller:

1. Increase the bad check service charge to the national retail median of \$30.

Management's Comments

Management agreed with the recommendation to increase the bad check fee and with the monetary impact of \$577,115. However, management disagreed that the fee increase will reduce costs. Instead, they view the increased fee as an offset to the cost of bad check acceptance. In addition, management did not believe the increased bad check fee will reduce the number of bad checks. The bad check fee increase will take effect by June 30, 2012. See [Appendix C](#) for management's comments, in their entirety.

Evaluation of Management's Comments

The U.S. Postal Service Office of Inspector General (OIG) considers management's comments responsive to the recommendation, and corrective action should resolve the issue identified in the report. Regarding management's concern about the characterization of the increase in bad check fees, we are in agreement that the increased fee will have a positive impact on the cost of bad check acceptance. Further, based on our research, there are industry studies suggesting that raising fees deter behaviors. Thus, we believe raising bad check fees will reduce the number of bad checks.

The OIG considers the recommendation significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action is completed. The recommendation should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed.

⁴ Moebs Services, "Retailers Charge for Bounced Checks Surpasses Banks/Credit Union NSF Fees, August 10, 2010."

Appendix A: Additional Information

Background

The Postal Service receives more than \$12 billion in check payments and about \$20 million in bad checks annually. Personnel processed bad checks at three units: the Accounts Reconciliation and Finance Branches at the Information Technology and Accounting Service Center (IT/ASC) in Eagan, MN, and the National Customer Service Center (NCSC) in Memphis, TN. The Accounts Reconciliation Branch processed bad checks from retail locations such as post offices and business mail entry units. The Finance Branch processed bad checks from lockbox customers. The NCSC processed bad checks payments received for licensing fees, address management system updates, and other postal services. In FY 2011, the number of bad checks processed by each group ranged from one to more than 55,000. See Table 1 for bad checks processed each year by each group.

Table 1: Number of Bad Checks Processed By Group

Number of Bad Checks Processed				
Fiscal Year	Accounts Reconciliation Branch	Finance Branch	NCSC	Total
FY 2009	82,178	1,028	1	83,207
FY 2010	67,996	1,166	2	69,164
FY 2011	55,578	888	1	56,467
Total	205,752	3,082	4	208,838

Source: Postal Service Return Check Management System and POS system.

Accounting Services⁵ is responsible for collection and resolution of all checks returned from Postal Service bank accounts. Accounting Services personnel send nonsufficient funds checks valued at less than \$5,000 to a collection agency to pursue and attempt collection. Accounting Services personnel pursue and attempt collection of nonsufficient checks greater than \$5,000 and all other types of bad checks, such as stop payment and account closed. After 37 days,⁶ if Accounting Services personnel are unable to collect on the bad checks, they forward the uncollected checks to a collection agency to pursue. In addition, personnel must record all bad checks in RCMS.⁷ The RCMS maintains detailed information on each bad check, such as customer's name, check amount, check date, bank account number, reason for not clearing, and amount collected. The Accounts Reconciliation Branch is on the web-based RCMS, whereas the Finance Branch is on the old stand-alone RCMS. Information Technology is merging the Finance Branch's RCMS into the Accounts Reconciliation Branch's web-based RCMS. The system merger is in the test phase, and management expects completion by December 31, 2011.

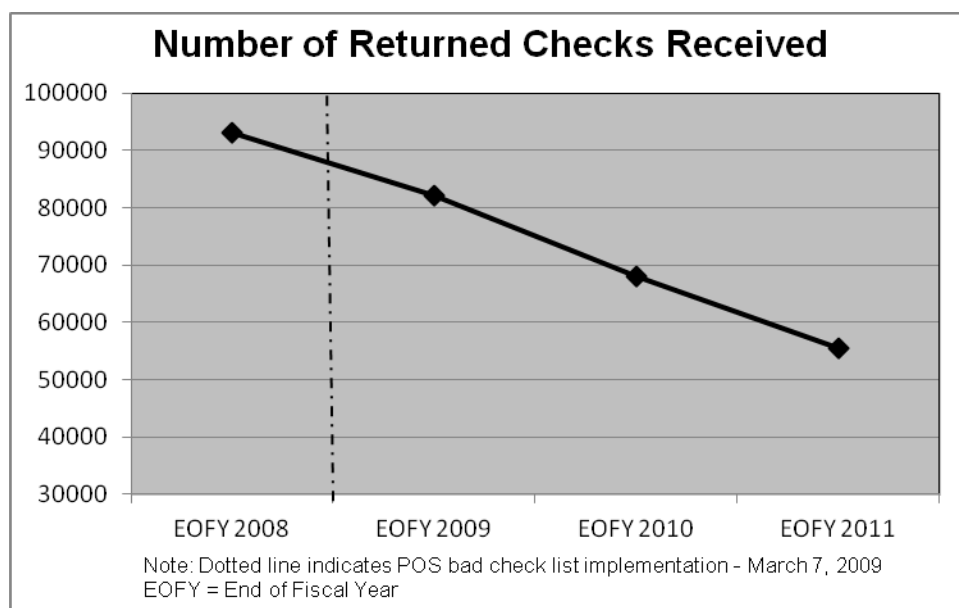
⁵ Accounting Services manages accounting processes and procedures for the Postal Service.

⁶ Customers have 30 days to repay bad checks, and 7 additional days are included for receipt of payment.

⁷ Handbook F-1- *Accounting and Reporting Policy*, Section 3-1.3.2, March 2011.

Accounting Services monitors customers who present bad checks and generates a national bad check list. Accounting Services removes customers from the bad check list once they have paid their debt. On March 7, 2009, management implemented the electronic bad check list at retail units using the POS system functionality, allowing units to compare the customer's check against the electronic bad check list during the endorsement process. The system updates the electronic listing nightly, and Accounting Services sends hard copy reports to Integrated Retail Terminal⁸ and Money Order Voucher Entry System⁹ units monthly. Between FYs 2008 and 2011, the number of bad checks received declined significantly. Management attributed the decline in bad checks to the decrease in customer check use and the automation of the bad check identification process in the POS system. See Chart 1 for more details.

Chart 1. Number of Returned Checks Received Between FYs 2008 and 2011



Source: Postal Service Return Check Management System

Objectives, Scope, and Methodology

The objectives of our audit were to determine whether Postal Service policies and procedures to prevent and collect bad checks are effective and efficient and whether the process for collecting bad checks is cost effective. To accomplish our objectives, we:

- Interviewed finance, accounting, and information technology personnel at Postal Service Headquarters, the IT/ASC in Eagan, MN; and the NCSC in Memphis, TN.
- Interviewed Federal Reserve Board management about the check-clearing process.
- Obtained and reviewed bad check data for FYs 2008 through 2011.

⁸ The first-generation sales transaction system used at select Postal Service facilities.

⁹ A web-based system developed to aid in processing manual Postal Service Forms 1412, Daily Financial Report, Account Identifier Codes entries, and money order vouchers.

- Observed technicians sorting bad checks, recording bad check data into RCMS, and preparing customer notification letters at the Accounts Reconciliation Branch in Eagan, MN.
- Observed the check acceptance process at three Postal Service facilities.¹⁰
- Evaluated bad check operating procedures and staffing levels.
- Researched generally accepted bad check policies and procedures.
- Researched new bad check technologies.

We conducted this audit from October 2010 through January 2012 in accordance with generally accepted government auditing standards and included such tests of internal controls as we considered necessary under the circumstances. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We discussed our observations and conclusions with management on December 6, 2011, and included their comments where appropriate.

We assessed the reliability of RCMS data by interviewing agency officials knowledgeable about the system and through observations of the data entry process. We determined that the data were sufficiently reliable for the purposes of this report.

[Prior Audit Coverage](#)

The OIG did not identify any prior audits or reviews related to the objectives of this audit.

¹⁰ [REDACTED]

Appendix B: Monetary and Other Impacts

Monetary Impacts

Finding	Impact Category	Amount
Bad Check Service Fees	Questioned Costs ¹¹	\$577,115

Increasing the bad check service fee for nonsufficient funds from \$25 to \$30 could have reduced costs by \$204,375 in FY 2010 and \$165,065 in FY 2011. For FYs 2012 and 2013, we used linear regression analysis¹² on the moving average of the number of bad checks to estimate cost reductions of \$207,675.

¹¹ Questioned costs are unnecessary, unreasonable, or unsupported costs or an alleged violation of law, regulation, or contract. These costs may be recoverable or unrecoverable and are usually a result of historical events.

¹² Linear regression is the method of estimating the conditional expected value of one variable y given the values of some other variable or variables x .

Appendix C: Management's Comments

TIMOTHY F. O'REILLY
VICE PRESIDENT, CONTROLLER



January 4, 2012

Shirian Holland
Acting Director, Audit Operations

SUBJECT: Draft Audit Report - Bad Check Prevention and Collection –
(Report Number FI-AR-12-DRAFT)

This provides management's comments to the subject report. We appreciate the opportunity to review and comment.

OIG's Recommendation:

We recommend the Vice President, Controller: Increase the bad check service charge to the national retail median of \$30.

Management Response / Action Plan:

Management agrees with the recommendation to the increase of bad check fees from \$25 to \$30. Management does not agree with the characterization of this increase as a reduction in cost. Management views the fee as an offset to the cost of bad check acceptance and does not believe that a higher fee will diminish the number of bad checks. Management agrees with the OIG calculations of \$577,115 in Questioned Costs, but disagrees with how those calculations are characterized to reduce bad check expenses.

Target Implementation Date:

Management will increase the bad check fee during the third quarter of Fiscal Year 2012.

Responsible Official:

The Manager of Revenue and Field Accounting is responsible for the implementation of the new check fee.

We do not believe that this report or comments contain any proprietary or business information prohibiting disclosure pursuant to the Freedom of Information Act.

A handwritten signature in blue ink that reads "Tim O'Reilly".

Tim O'Reilly

cc: Joseph Corbett
Ellis A. Burgoyne
Pritha Mehra
Corporate Audit and Response Management

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