



INVENTORY OBSERVATION – FY 2002

Exit Conference Date: November 4, 2002

Release Date: November 6, 2002

Report No. 03-01

CITY OF ORLANDO

OFFICE OF AUDIT AND EVALUATION

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CITY OF ORLANDO

MEMORANDUM

To: Rebecca A. Ares
Administrative Services/Management and Budget Director
David L. Metzker
Public Works Director

From: Beryl H. Davis, CPA, CGFM
Audit and Evaluation Director

Date: Exit Conference Date: November 4, 2002
Release Date: November 6, 2002

Subject: Inventory Observation – FY 2002 (Report No. 03-01)

The Office of Audit and Evaluation has observed the physical inventory counts of Vehicle Parts, City Stores, Sign Shop, Iron Bridge, and Fuel inventories for the fiscal year ended (FYE) September 30, 2002. Our objective was to obtain reasonable assurance as to the accuracy of the inventory count and value. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, we included those audit procedures we considered necessary in the circumstances. These procedures included observation of the count of the selected inventories, test counts, tests of prices, and comparison of the inventory according to the physical count to the perpetual inventory report if available.

In our opinion, the following inventory amounts are correct in all material respects:

Vehicle Parts	\$ 431,046
City Stores	377,797
Sign Shop	316,603
Iron Bridge	172,374
Fuel	11,666

We selected Fuel as one of the City inventories to observe this year because we have not observed this count in recent years, and because the balance of the Fuel inventory account in the City's general ledger was relatively high. The Fuel account is subject to large fluctuations during the year because of the City's pattern of Fuel acquisitions and charges to programs, and we noted that the balance in the account was over \$400,000 at one point.

Based upon our observations during this review, we have prepared an attachment containing several recommendations. It is important to note that our review was not designed to determine the adequacy of internal controls over inventory. There is no perpetual inventory system for Sign Shop and Iron Bridge. As we have noted in the past, without such records it is difficult to determine whether misappropriation has occurred. We can determine what the count is, but not what it should be. Management is responsible for assessing the benefit relative to the cost of preparing perpetual inventory records.

Several recommendations are made to Purchasing, including the need to: prepare a definitive count sheet listing Fuel tanks to be included in City inventory; establish a two-member Fuel count team; and have a police supervisor review a Fuel-related Procard that is used by police officers but held in the name of Purchasing staff. Other recommendations to Purchasing are for: Vehicle Parts to improve the reliability and efficiency of its physical count; and City Stores to improve its variance reporting.

A recommendation is made to Sign Shop to improve its procedures for pricing and extending its final inventory report.

If you have any questions, please contact our office.

BHD/am

c: Honorable Glenda E Hood, Mayor
Richard L. Levey, AICP, Chief Administrative Officer
Kevin J. Edmonds, Deputy Chief Administrative Officer
Robert R. Garner, Comptroller
Jon Mead, Purchasing and Materials Management Director
James E. Vick, Fleet/Facilities Management Bureau Chief
Harry A. Campbell, Transp. Engineering Bureau Chief/Transp. Engineer
David S. Sloan, Wastewater Bureau Chief
KPMG, LLP

Attachment—Issues and Recommendations

ISSUES AND RECOMMENDATIONS

During our audit, we identified certain procedures and management practices that could be improved. Our audit was not designed or intended to be a detailed study of every system, procedure, or transaction. Accordingly, the issues and recommendations presented in this report should not be considered as all-inclusive of areas where improvements may be needed.

All Fuel tanks to be inventoried should be listed on a count sheet.

On the morning of the inventory, there was no count sheet available to identify the location of storage tanks holding City-owned Fuel and the type of Fuel that should be contained in these tanks. City Policy and Procedure for Vehicle and Equipment Management System, which is used for Fuel management and inventory counting, requires pre-numbered Inventory Count Sheets. There was confusion among various personnel about who should provide this list. After creating a list of tanks to be measured, Purchasing staff contacted the count person and auditor during the inventory taking process to change several locations; several days afterward, 4 additional tanks to be included in the inventory were supplied to the auditor. For effective management control, the responsible party should have available some means of readily identifying what Fuel tanks should be included in the City's Fuel inventory ledger account. Because the Fuel may be diesel or unleaded, a list should identify the tanks as to the location and type of Fuel they contain, for pricing and valuation purposes.

The result was that, on the date of the inventory, we were not confident that the Fuel was measured in all and only the tanks that should have been included in the Fuel inventory for fiscal year ended September 2002.

Subsequent to the date of the inventory, Purchasing management developed a definitive list of the tanks containing City-owned Fuel that should be used for taking inventory. We then compared Purchasing's final list to the various lists that Purchasing's count staff had used to determine the City-owned Fuel quantities on the date of the inventory count. This new list is what enabled us to obtain reasonable assurance that all tanks were measured on the date of the inventory count and thus that

the Fuel quantities as determined by Purchasing staff are reasonably accurate.

The importance of having an accurate list of tanks containing City-owned Fuel is explained in part as follows. The City owns numerous Fuel tanks throughout the City. Many tanks contain Fuel owned not by the City, but by a vendor, Taylor Petroleum. The Fuel in these tanks should not be included in the City's Fuel inventory ledger account. This is because Taylor Petroleum owns this Fuel and, using a computerized chip in each vehicle, charges the City for the amount of Fuel dispensed into each vehicle. All tanks containing Fuel not owned by the City should be identified and distinguished from those containing City-owned Fuel.

Recommendation 1. **We recommend that the Purchasing and Materials Management Director** ensure that count sheets are available to clearly identify all of the Fuel tanks owned by the City, including whether the City owns the Fuel and the type of Fuel in the tanks.

Response We concur. Materials Management will create pre-numbered count sheets with full descriptions, size, and type of fuel for each site. A list of the sites has been provided at this time.

Fuel inventory count team should consist of two members. Purchasing assigned only one individual to the annual Fuel inventory measurement. Accuracy and control of inventory information are better ensured when two individuals are assigned to each count team.

Recommendation 2. **We recommend that the Purchasing and Materials Management Director** assign two individuals familiar with the Fuel inventory to constitute a count team for each annual inventory.

Response We concur. All fuel inventories will comprise of two individuals, familiar with fuel inventories.

Fuel Procard statements should be reviewed by an OPD supervisor.

Fuel is purchased using a Procurement Card (Procard) at a certain Amoco station by officers of the Orlando Police Department (OPD) who patrol the southwest Orlando area. This Procard is assigned to a Materials Management Supervisor in Purchasing who, together with the Purchasing and Materials Management Director, approves the Procard statements. The invoices and statements for this Procard are not routed to an OPD supervisor who would have access to information about the officers' assignments and expected Fuel usage, and authority to question their activities.

City Procard policy for approval of Procard purchases is based on an assumption that the cardholder is both the accountable party and the purchaser of the items. Procard policy also prohibits use of Procards for the purchase of Fuel, so if there are exceptions these should be written into City Procard policy.

To improve the control over the use of this Procard, it should be assigned to the OPD employee who would be most knowledgeable about the activities of the officers who use this card, and about the propriety of these Fuel expenditures. If this is not possible, the statements and related invoices should be provided to such a responsible OPD employee monthly for review and approval.

Recommendation 3.

We recommend that the Purchasing and Materials Management Director (1) transfer the Procard used by OPD officers for Fuel purchases to the OPD employee with the most knowledge and responsibility for this Fuel use, or, if this is not possible, (2) forward the Procard statements and invoices to such OPD employee monthly for review and approval.

Response

We partially concur. Materials Management would be glad to transfer the fuel card to OPD for their use. Due to command change in this division multiple cards would be issued and canceled as the command changes. Should Materials Management retain the Pro-card for fuel for OPD we will insure the Pro-card statement each month is forwarded to the supervisor in charge of the International Drive patrol division.

Materials Management is currently ready to issue fuel cards through an agreement with Shell fueling services, to provide an alternate means to obtain fuel at the contacted price per gallon in remote areas. This will eliminate the need for a Pro-card for fuel altogether. Accounting and Control will be implementing procedures for the use of these cards.

Vehicle Parts should improve reliability and efficiency of the physical count.

We found during our test counts of 74 items that there were 9 differences between the quantities we counted and the quantities Vehicle Parts personnel counted, which is a 12% error rate. Further, we found that there were 11 differences, a 15% error rate, between the quantities in our test counts compared to the amounts appearing in the final inventory report prepared by the Property Control Supervisor for the Vehicle Parts inventory. To obtain the highest possible level of accuracy, the Property Control Supervisor informed us that he directed that all items be manually recounted at least once.

The Property Control Supervisor is utilizing the manual count, performed September 26 through October 2, 2002, as the final inventory record and this is the inventory document upon which we performed tests. The plan was to perform both a manual count and an electronic count at the same time, to be completed in a total of 2 days. Purchasing management's attempt to perform an electronic count was a proactive effort to save time and increase controls in the future. The software update, enabling the use of the electronic devices and bar codes, was not installed until approximately 2 weeks before the inventory count date.

Because of technical difficulties that had not been resolved before the count commenced, errors occurred in connection with the electronic count. As a result the electronic count was not utilized.

To ensure that the inventory count is performed most accurately and efficiently in the future, we recommend that adequate preparation be made for utilization of the electronic count method. Performance of an interim electronic count of the full

inventory or of selected inventory items on a cyclical basis during the upcoming fiscal year, along with analysis of the errors, may help the Property Control Supervisor to obtain a reliable count more efficiently for the next fiscal year.

Recommendation 4. **We recommend that the Purchasing and Materials Management Director** ensure adequate preparation is made for the next physical inventory count, including conducting interim counts as appropriate.

Response We concur. Additional safeguards to insure accurate inventory procedure are being written and should be in place by December 2002.

Vehicle Parts will be conducting nine-cycle counts per year to insure annual inventories are on target, and any problem area is corrected before year-end.

Materials Management Supervisor has conferred with the Property Control Manager of Vehicle Parts, to insure that a pre-inventory set-up is in-place before the annual inventory is taken. Vehicle Parts Manager will maintain adequate locations for all parts, insure areas are easily found and none of the parts mislabeled.

Bar code devices will be operational and verified accounting procedures will be in place by November 30, 2002.

City Stores report for variances between perpetual and physical counts should be improved and count data should be properly input.

When we reviewed a City Stores variance report comparing the perpetual inventory line item quantities with the quantities as counted, we noticed that the totals of the columns did not add correctly. We inquired about this from the Financial Systems Manager familiar with this inventory system, which is a part of the City's JDEdwards OneWorld general ledger system. She indicated that this inventory software is designed to make its calculations of variances based upon actual input of count data in the "Quantity Counted" column. Because Purchasing staff did not enter zero as the quantity on a number of lines, the report not extend properly. She stated that the resulting variance of

\$15,668, posted to the general ledger was correct in the sense that it represents only the items Purchasing entered. After further research identifying variance extensions that were not calculated in the original report, Purchasing staff determined that the actual variance amount should be (\$590) instead. We discussed with the Financial Systems Manager the need to adjust the general ledger as of September 30, 2002 to reflect a (\$590) adjustment instead of the \$15,668 that was already posted to the general ledger.

Standards require that computer-processed data are valid and reliable. If the Financial Systems Manager does not believe it is appropriate to change the report or software logic, we suggest that a procedure be placed in writing to ensure that data is properly input and that this report is properly interpreted.

Recommendation 5. **We recommend that the Purchasing and Materials Management Director** (1) determine with Accounting whether the inventory report or logic should be changed to ensure that extensions and totals posting to the ledger are complete and correct, and (2) establish a written procedure to ensure that physical count data is properly entered and that the variance report is properly interpreted.

Response We concur. Materials Management is currently working with Technology Management to correct this problem. Written instructions will be issued to insure that the manual inventory counts are entered as zeros instead of blank lines to insure data accuracy. The report JDE produces shows this amount as the value of the counted inventory/the value of the on hand value. Due to the way JDE represents items within a specific location that is not counted but also have no items in that location JDE will show a variance in this column that had a previous value that once existed. This is due to the Location Master that was set up in the beginning of the implementation. We are currently updating the Location Master to the actual bin location, this should correct the erroneous value.

City Stores inventory is correct in actual inventory variance of <\$590.08>. This represents an annual inventory loss of 0.16%. City Stores will also be conducting 9-cycle counts throughout the year to insure an accurate count during annual inventory.

The bar code inventory and sale order system will be operational by November 30, 2002. This should improve control over the manual system used at last inventory.

Sign Shop should improve its procedures for pricing and extending its final inventory report.

We found a number of errors in the valuation of the final inventory report produced by the Sign Shop. In summary, we detected 41 errors. Of these, 22 were overstatements totaling \$18,528 and 19 were understatements totaling \$15,692. The net overstatement was \$2,836. The largest line item error we discovered was \$9,578. The types of errors we identified were: 2 items that should not have been counted; 1 item with improper unit of measure; no price for 2 items; 13 items with incorrect prices; 16 items with incorrect extensions; and 7 incorrectly totaled pages.

We have suggested that Sign Shop management review its inventory listing to determine if there are other errors. Management should contact the Accounting and Control Bureau for further assistance with establishing and carrying out inventory count and control procedures whenever needed.

After we tested the inventory valuation for FY 2001, 56% of items tested had similar errors, necessitating a downward adjustment of \$17,529. At that time we recommended that written controls and a review process be adopted.

Recommendation 6. **We recommend that Sign Shop management** implement written controls including a review process to ensure that all annual inventory valuation procedures are accurately performed.

Response We concur. The Signs and Markings Section will submit a request to the Technology Management Department to identify and acquire an inventory program to account for the quantity and cost of materials.

The Bureau will submit a new position request as a part of the next Budget submittal. The new position, titled “Property/Inventory Clerk,” would manage the inventory, handle distribution and track costs for signs, markings and signals.
