

Final Audit Follow-Up

As of September 30, 2010



Sam M. McCall, Ph.D., CPA, CGFM, CIA, CGAP
City Auditor

Municipal Supply Center Transition to Electric-Utility Supply Center (Report #1014, Issued April 30, 2010)

Report #1101

January 6, 2011

Summary

This is the first and final follow-up audit conducted after the issuance of the original audit report #1014, Municipal Supply Center Transition to Electric-Utility Supply Center (USC).

There were 14 action steps to be completed during this follow-up period, and all 14 steps have either been completed or have had significant progress made. Completed steps included:

- Completed the reconciliation of the physical inventory count to the inventory value recorded in the City's financial system, identify and resolve any outstanding issues, document any adjustments to inventory including the reasons for the adjustments, and obtain concurrence and acceptance from Electric for the reconciliation, adjustments, and reasons for adjustments.
- Established the beginning inventory balance of \$10,163,085 transferred to Electric on October 1, 2009.
- Ensured that inventory item locations questioned during the transition physical inventory cycle count were corrected and are able to be located in the warehouse.
- Developed a process for assigning unique identification numbers to all inventoried items, including those of a similar nature and assigned unique item numbers for similar items that were identified during the transfer cycle count.

- Removed from inventory and surplused all items that were identified during the transition cycle count as obsolete; established a process for identifying obsolete items and removing them from the inventory.
- Developed a process to identify items that cannot be used independently of others, and organized and recorded the dependent items as "kits" to ensure users receive the proper equipment when the items are issued.
- Investigated the issue of recording inventory counts and changes to inventory to improve the entry of those counts into the system in a more efficient and timely manner.
- Developed a "mark up" amount and process to fund the warehouse operations.
- Implemented processes to increase the efficiency of the replenishment process. [Significant progress has been made in this area, but continuing efforts are still needed.]
- Developed and implemented the most accurate methods for measuring inventory units.
- Explored methods and revised inventory reports to better assist in the inventory counts.
- Developed various monthly inventory reports for Electric Utility and Underground Utility to allow these departments to timely review their inventory use.

- Investigated, researched, and implemented various practices to increase the efficiency and effectiveness of warehouse operations.
- Developed processes to review the security measures in place at the warehouse to safeguard the City’s assets maintained by Electric at the Utility Supply Center. [Significant progress has been made in this area, but continuing efforts are still needed.]

The efforts made by the Electric Utility USC management and staff and DMA Procurement Services and Accounting Services have resulted in greater accountability of the transfer of over \$10 million in inventory items.

We appreciated the full cooperation provided during this audit follow up by staff from the Electric Utility and DMA Procurement Services and Accounting Services Divisions.

Scope, Objectives, and Methodology

We conducted the original audit and this subsequent follow-up audit in accordance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Original Report #1014

The objectives of the audit were to observe the warehouse transition process to: determine compliance with City policies and procedures throughout the transition process; ensure appropriate inventory valuation; and ensure proper accounting for inventories.

Report #1101

This is our first and final follow-up on action plan steps identified in audit report #1014. The purpose of this follow-up is to report on the progress and status in completing the action plan steps due for completion as of September 30, 2010. To obtain information, we reviewed relevant documentation, including policies and procedures and reports; and interviewed key staff.

Previous Conditions and Current Status

In report #1014, we audited the City’s transfer of the Municipal Supply Center (MSC) warehouse, with an inventory value of approximately \$10.3 million, from Department of Management and Administration (DMA) Procurement Division to the Electric Utility. After the transfer, the warehouse is referred to as the Utility Supply Center (USC) as it only supports the Electric Utility and Underground Utility. The inventory items warehoused by the City and recorded in PeopleSoft at October 1, 2009, were valued at \$11,231,489, with 91% of the total value located at MSC.

**Table 1
Warehouse Inventory Value
at October 1, 2009**

Warehouse	Total Value October 1, 2009	Percent of Value
Municipal Supply Center	\$ 10,293,414 (note 1)	91%
Water	\$ 550,651	5%
Public Works Warehouses	\$ 187,544	2%
Electric Transmission and Distribution Warehouse	\$ 138,145	1%
Gas Meter Warehouse	\$ 61,735	1%
Total Inventories	\$ 11,231,489	100%

Source: Audit Report #1014

Note (1): After the inventory reconciliation was completed in July 2010, the MSC warehouse value at October 1, 2009 was revised to \$10,163,085.

In the transition of the MSC warehouse, the objectives of Electric Utility included conducting a safe and orderly complete physical count, consistent with Generally Accepted Accounting Principles (GAAP), of the items located at MSC, prior to the transition of the inventory function to Electric.

We concluded that during the transition, Procurement, Accounting Services, and Electric have worked together to comply with applicable City policies and procedures and continue to consider the policies as additional work is completed related to the transition. We provided assurances that the following were accomplished:

- Written procedures to ensure compliance with City policies and procedures were developed prior to the physical inventory count and were discussed with individuals taking the inventory count;
- The physical inventory count was conducted in an orderly, professional manner with supervisory staff in attendance during the count;
- A diligent attempt was made to account for all items located in the warehouse and if obsolete items were identified, those items were marked for disposal through appropriate surplus procedures; and
- A reconciliation between the physical count and the inventory recorded in PeopleSoft was in progress to ensure a proper accounting for inventory and an appropriate inventory valuation.

During our observation of the warehouse transition process, there were some differences discovered between the physical count and the inventory value recorded in the accounting records that needed to be resolved to establish an agreed-upon beginning inventory value for the Electric Utility Supply Center (USC) as of October 1, 2009. Additionally, there were some operational issues that Electric staff needed to address to implement procedures and processes to improve the accounting for and safeguarding of the warehouse inventory.

We provided the following recommendations to the Electric USC to address those operational issues:

- Complete the reconciliation between the physical inventory count and the accounting inventory value;
- Improve how inventory is maintained in the warehouse;
- Better account for warehouse overhead;
- More efficiently and effectively utilize PeopleSoft to account for inventory;
- Obtain needed warehouse and office equipment; and
- Improve the physical security of City assets stored at the warehouse.

Table 2 below provides the steps from management's action plan to implement the recommendations and the current status of each. All 14 action plan steps from the original audit report were due to be completed by September 30, 2010, and have been completed.

Table 2
Action Plan Steps from Report #1014
Due as of September 30, 2010, and Current Status

Action Plan Steps Due As of September 30, 2010	Current Status
<i>To Appropriately Value the Inventory</i>	
<ul style="list-style-type: none"> • Complete the reconciliation of the physical inventory count to the inventory value recorded in PeopleSoft and identify and resolve any outstanding issues. Document any adjustments to inventory including the reasons for the adjustments. Obtain concurrence and acceptance from Electric for the reconciliation, adjustments, and reasons for adjustments. 	<ul style="list-style-type: none"> ✓ Completed. Accounting Services completed, and Electric Utility accepted, the reconciliation of the inventory balance transferred (\$10,163,085) from the Department of Management and Administration Municipal Supply Center to the Electric Utility as of October 1, 2009.
<ul style="list-style-type: none"> • Establish a beginning balance for transition to Electric. 	<ul style="list-style-type: none"> ✓ Completed. Accounting Services input the required entries to move the inventory account balance from the Procurement Fund to the Electric Supply Center Fund.
<i>To Properly Account for Inventories</i>	
<ul style="list-style-type: none"> • Ensure that inventory item locations questioned during the transition physical inventory cycle count are corrected and are sufficient to locate the items in the warehouse. 	<ul style="list-style-type: none"> ✓ Completed. Since the transition inventory, USC staff added bar-codes to all items stocked at the warehouse. While doing this, they identified each item and worked with Utility liaisons to ascertain if the older items should continue to be stocked or discarded. Those items identified by the Utility as obsolete, damaged, or in non-operational condition were either transferred to surplus or returned to a vendor for possible credits.
<ul style="list-style-type: none"> • a. Develop a process for assignment of unique identification numbers to all inventoried items, including those of a similar nature; and • b. Assign unique item numbers for similar items that were identified during the transfer cycle count. 	<ul style="list-style-type: none"> ✓ a. Completed. A process was developed for assigning unique identification numbers to all inventoried items. ✓ b. Completed. USC staff consults with Utility experts when they encounter different items with the same ID number to clarify they are different, and they assign a new number to one of the items.
<ul style="list-style-type: none"> • a. Remove from inventory and surplus all items that were identified during the transition cycle count as obsolete; • b. Establish a process for identification of obsolete items to ensure that items are reviewed periodically by the user departments; and 	<ul style="list-style-type: none"> ✓ a. Completed. USC staff worked with Utility Liaisons to identify and surplus obsolete inventory items. ✓ b. Completed. USC staff worked with Information Systems Services to create a "slow moving" inventory report to identify those items that are not being issued within a

<ul style="list-style-type: none"> c. Develop a process to ensure removal of items identified as obsolete from the warehouse inventory. 	<p>specified time period.</p> <ul style="list-style-type: none"> ✓ c. Completed. USC staff work with the appropriate Utility liaison to get approval before removing items identified as obsolete. Obsolete items are documented and labeled "SURPLUS" with the date. Items are moved to Procurement's Surplus and disposed of accordingly. USC staff then requests Procurement to inactivate the item in the PS Inventory system.
<ul style="list-style-type: none"> a. Develop a process to identify items that cannot be used independently of others; and b. Organize and record the dependent items as "kits" to ensure users receive the proper equipment when the items are issued. 	<ul style="list-style-type: none"> ✓ a. Completed. USC staff has implemented a process to identify items that cannot be used independently of others. ✓ b. Completed. USC staff implemented a process to organize and record the dependent inventory items as "kits" to ensure users receive the proper equipment when the items are issued.
<ul style="list-style-type: none"> Investigate the issue of recording inventory counts and changes to inventory to improve the entry of those counts into the system in a more efficient and timely manner. 	<ul style="list-style-type: none"> ✓ Completed. USC staff worked with a contractor to implement a barcoding solution to all inventory items to standardize the inventory receipt and issuance process and help expedite the inventory process. The inventory conducted in October 2009 during the transition took over three weeks and even longer to clean up the records. The inventory conducted in October 2010 took approximately three days with only a limited additional time to clean up the records.
<p><i>To Develop A Warehouse Overhead Charge to Departments</i></p>	
<ul style="list-style-type: none"> Continue efforts to allow and account for warehouse operations through a mark-up process. The warehouse operations will no longer be a part of the City's cost allocation process. 	<ul style="list-style-type: none"> ✓ Completed. Budget has removed warehoused operations from the City's cost allocation process and the Electric Utility has implemented a mark-up process to bill departments a 12% mark-up rate on inventory items issued on a monthly basis.
<p><i>To Utilize the City's Financial System in the Inventory Process</i></p>	
<ul style="list-style-type: none"> Continue efforts to make the replenishment process more efficient. 	<ul style="list-style-type: none"> ✓ Completed, but needs to be ongoing. Changes have been and are being made to make replenishment as efficient as possible. There are limitations in the system and set up that prevent user access from being assigned at the business unit (i.e., inventory) level. These limitations require inventory users access be limited to requisitioning level and involves the procurement agents to approve

	and process Purchase Orders.
<ul style="list-style-type: none"> • Develop a process to review units of measure assigned to various inventory items in PeopleSoft and determine the most accurate methods for items in question. 	<ul style="list-style-type: none"> ✓ Completed. USC staff reviewed the current units of measure assigned to various inventory items in PeopleSoft and made adjustments as necessary, and implemented a process to determine the units of measure for new items.
<ul style="list-style-type: none"> • Explore methods to include a complete description of inventory items in inventory reports to allow accurate identification of items by warehouse staff and/or inventory counters. 	<ul style="list-style-type: none"> ✓ Completed. Procurement and USC worked with Information Systems Services to produce a report to use during inventory counts that provides the item numbers, full descriptions, and variances between number counted and in the system records.
<ul style="list-style-type: none"> • Continue efforts to more efficiently produce monthly inventory reports through PeopleSoft for Electric Utility and Underground Utility to allow these departments to timely review inventory use. 	<ul style="list-style-type: none"> ✓ Completed prior to the release of the original audit report.
<i>To Complete the Transition of the Warehouse from DMA to Electric Utility</i>	
<ul style="list-style-type: none"> • Continue to investigate and determine the most efficient and effective equipment to best manage warehouse operations. 	<ul style="list-style-type: none"> ✓ Completed. USC staff has investigated (and continue to investigate) options to assist them in managing the warehouse more efficiently and effectively.
<ul style="list-style-type: none"> • Develop a process to review the security measures in place at the warehouse to safeguard the City’s assets maintained by Electric at the Utility Supply Center. 	<ul style="list-style-type: none"> ✓ Completed, but needs to be ongoing. During our follow up review of access capabilities, we noted five users (Accounting Services, Procurement, and outside consultant) that should not have access into inventory processes. Access for these users was removed. Audit Comment: <u>We recommend</u> that management implement processes to periodically review users’ access capabilities to ensure that users only have access into the processes and data where they are authorized.

Table Legend:

- Issue in the original audit
- ✓ Issue Addressed and Resolved
- ◇ Issue Partially Completed

Conclusion

Significant progress was made to address all inventory and warehouse issues identified in the original audit report. Accordingly, this is the first and final follow-up audit conducted after the issuance of the original audit report #1014, Municipal Supply Center Transition to Electric-Utility Supply Center.

As described in detail in Table 3, 14 of the 14 action plan steps due this period have been completed. For two of these steps, significant progress was made, but continuing efforts are still needed.

The efforts made by the Electric Utility USC management and staff and DMA Procurement Services and Accounting Services have resulted in greater accountability of the transfer of over \$10 million in inventory items.

We appreciate the full cooperation provided during this audit follow up from staff in the Electric Utility and DMA Procurement Services and Accounting Services Divisions.

Appointed Official's Response

City Manager:

I am extremely pleased to see that 100% of the action plan steps are complete with this first and final follow-up audit. Staff's efforts to ensure proper resolution of risk identified subsequent to the Municipal Supply Center transition to the Electric Utility Supply Center, reflects management's continuous commitment to ensure that adequate processes, procedures and safeguards are in place to increase the efficiency and effectiveness of our utility warehouse program. I would like to thank the City Auditor's Office, the Department of Management and Administration and the Electric Utility Department for their hard work on this audit.

Copies of this audit follow-up #1101 or audit report #1014 may be obtained from the City Auditor's website (<http://talgov.com/auditing/index.cfm>) or via request by telephone (850 / 891-8397), by FAX (850 / 891-0912), by mail or in person (Office of the City Auditor, 300 S. Adams Street, Mail Box A-22, Tallahassee, FL 32301-1731), or by e-mail (auditors@talgov.com).

Audit follow-up conducted by:
Beth Breier, CPA, CISA, Audit Manager
Sam M. McCall, Ph.D., CPA, CGFM, CIA, CGAP, City Auditor