Audit of the Department of Public Works Fleet Services Inventory

W. MARTIN MORICS
City Comptroller
City of Milwaukee, Wisconsin

June 2011

Table of Contents

Transmittal Letter 1
I Scope and Objectives 2
II Background 2
III Audit Conclusions and Recommendations 4
A. Summary Conclusions 4
B. Accuracy of Fleet Inventory Records 8
Recommendation 1: Improve accuracy of Fleet inventory values 12
Recommendation 2: Eliminate all "off-the-books" inventory 12
Recommendation 3: Redesign inventory reconciliation process 13
C. Fleet Inventory Internal Control Policy and Procedures 13
Recommendation 4: Expand purchasing guidance in DPW policy 16
Recommendation 5: Clarify DPW definition of inventory 16
Recommendation 6: Formalize and document Fleet procedures 16
Recommendation 7: Reduce overlapping job responsibilities 16
Recommendation 8: Enhance controls over manual adjustments 17
D. Fleet Inventory Physical Security 17
Recommendation 9: Improve physical security 19
E. Fleet Inventory Management 20
Recommendation 10: Re-evaluate Fleet inventory needs 22
Recommendation 11: Develop new monitoring tools and reports 23
Appendix A: Enhancing the reconciliation process 24
Appendix B: Lack of policy and procedures for special order purchases 26
Appendix C: Internal controls for accounting and transaction documentation 28
Appendix D: Cycle count and variance handling 31
Appendix E: Enhance controls over manual adjustments 33
Appendix F: Physical security controls 34
DPW Response 35

City of Milwaukee

Office of the Comptroller

W. Martin Morics, C.P.A.
Comptroller

Michael J. Daun
Deputy Comptroller

John M. Egan, C.P.A.
Special Deputy Comptroller

Craig D. Kammholz
Special Deputy Comptroller

June 24, 2011

To the Honorable
the Common Council
City of Milwaukee

Dear Council Members:

The attached report summarizes the results of our Audit of the Department of Public Works Fleet Services Inventory.

The audit determined that the Department of Public Works (DPW) has created an inventory internal control policy that generally provides good guidance to the divisions for establishing procedures to reduce risks associated with managing and maintaining inventory. However, Fleet Services (Fleet) has not sufficiently implemented the policy and improvements are needed in the areas of physical security controls, accuracy of inventory recordkeeping, internal controls over routine inventory transactions, and internal controls over non-inventory or special order item purchases. In addition, the audit found that DPW does not have sufficient tools in place to monitor compliance with the inventory policy nor to ensure inventory is getting recorded accurately. The audit makes eleven recommendations for improving Fleet's policy, procedures, and internal control over inventory.

Audit results are discussed in the Audit Conclusions and Recommendations section of the report, which is followed by the response from the Department of Public Works.

Appreciation is expressed to the Department of Public Works for the full cooperation extended to the auditors.

Sincerely,

W. MARTIN MORICS
Comptroller

COUNCIL 48 AFSCME UNION LABEL

Room 404, City Hall, 200 East Wells Street, Milwaukee, Wisconsin 53202 – 3566 Phone: (414) 286-3321, Fax: (414) 286-3281

I. Scope and Objectives

This Audit of the Department of Public Works Fleet Services Inventory was conducted in accordance with generally accepted government auditing standards. Those standards require that the audit obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The Office of the Comptroller believes that the evidence obtained provides a reasonable basis for the audit's findings and conclusions based on the audit objectives.

The audit covered commodity parts and supplies stocked by the Fleet Services Division (Fleet) for City vehicle maintenance and repair. The scope of the audit covered parts and supplies from receipt at the warehouse facility to installation on City vehicles. The audit included interviews of Fleet personnel, observations of warehouse activity, and examination of 2010 inventory processing transactions.

The objectives of the audit were to:

- Determine whether fleet inventory accounts and records are accurate and complete
- Evaluate fleet's inventory policies, procedures and internal controls
- Evaluate fleet's inventory physical security
- Evaluate fleet inventory management and oversight

The audit did not evaluate the procurement of fleet inventory, whether inventory holding costs are reasonable, or whether the inventory is right-sized for work activities. The audit also did not evaluate vehicle maintenance services purchased from outside vendors. These areas could be examined in future audits.

II. Background

The Department of Public Works (DPW) maintains inventory in material, commodities and supplies within its Infrastructure, Water Works and Operations Divisions. At year end 2010 and 2009, DPW reported total inventory of $10,183,000 and $9,691,000, respectively.

Approximately 12 percent of the DPW inventory is managed by Fleet in the Operations

Division. Fleet recorded inventory in the amount of $1,094,000 at year end 2010 and $1,122,000 at year end 2009. Fleet provides a critical service to the City by maintaining and repairing approximately 4,000 vehicles and equipment for other DPW divisions and departments including the Library, Health and Police Departments. In order to repair and maintain such a wide variety of equipment, Fleet manages over 5,000 unique commodity parts within five different stockroom locations with 75 percent stored at the Central Garage located at 21st and Canal Street. The remaining four stockrooms, called satellite locations, store inventory needed for the repair and maintenance crews working during the second shift. According to DPW, approximately 70 percent of Fleet's inventory is used to maintain and repair the City's heavy or special equipment that is unique to municipalities, such as garbage trucks, snow plows, and street sweepers. However, Fleet also services many common vehicle makes and models such as Ford pick-up trucks, Dodge cargo vans, and Honda Hybrids.

During 2010, Fleet purchased commodity parts, tools and supplies totaling about $3,772,000. Approximately $1,827,000 was recorded into inventory and $1,945,000 was directly purchased and expensed on a special order basis outside of the inventory process. Fleet had inventory disbursements for fiscal year 2010 of approximately $1,855,000 and ended the year with an inventory balance of $1,094,000. Based on historical averages, Fleet estimates that its inventory turns approximately 1.6 times per year. The audit calculated a similar inventory turnover ratio of 1.1 times during 2010.

Fleet utilizes the Fleet Focus automated system to track equipment, create work orders for repair and maintenance, and manage or monitor inventory on a perpetual basis. Within this system, Fleet can process all inventory transactions, including purchasing, receiving, disbursing, and adjusting the inventory. While the other DPW divisions utilize a module within the City's FMIS financial reporting system, Fleet Focus is a separate system not integrated with the FMIS. Therefore, unlike the other DPW divisions, a manual step is required to transfer information between the two systems for accurate financial reporting. Fleet performs periodic cycle counts of quantities on hand throughout a ten month period, ensuring that all commodity items are counted at least once. The fleet inventory has not been audited since 1994.

III. Audit Conclusions and Recommendations

A. Summary Conclusions

DPW has an inventory management policy that provides guidance to its divisions over physical security controls, proper inventory accounting and transaction documentation as well as procedures for handling variances identified through physical inventory counts. The audit reviewed this policy and found that a significant weakness in the policy allowed for Fleet to establish two different processes for purchasing, receiving, and tracking parts, tools, and supplies. One process was used to acquire inventory and the other process was used to acquire special order parts. Fleet's process for managing its inventoried parts is not fully in compliance with the DPW inventory policy and the audit identified some Fleet inventory practices that led to the current inventory records appearing to be incomplete and inaccurate. Fleet's process for managing the special order parts contains significant weaknesses in internal control and has resulted in unrecorded parts.

The audit concluded that DPW management has not provided adequate oversight over Fleet's inventory activity and related internal controls. The audit recommends that DPW management re-evaluate its inventory requirements, to determine if operational efficiencies could be made through establishing a more just-in-time approach for purchasing parts, tools and supplies, and consolidating and eliminating inventory locations among the divisions. The audit also recommends management formalize inventory procedures at Fleet and develop new monitoring tools and reports. Following is a summary of the audit findings and recommendations identified during the Fleet inventory audit.

Accuracy of Inventory Records

Fleet is not recording all of its commodity parts, tools, and supply purchases on a consistent basis. Fleet appears to be actively excluding certain commodity parts from inventory records, which is a lack of an internal control. It is also inaccurately adjusting recorded inventory parts to a lower value than the invoice value. The result is that inventory balances appear to be understated and certain commodity parts are at higher risk of theft or unauthorized removal because there is no record of the item existing. In addition, the audit found that DPW and Fleet are unable to account for differences

between inventory activity recorded in Fleet's inventory system and inventory activity recorded in the financial reporting system, FMIS. Unknown or unreconciled differences between the two systems imply inaccuracies occurring in the inventory management process.

Specific inaccuracies identified in the audit include,

- Current carrying prices of the inventory appear to be understated. Consumable items are recorded at a price of zero, which appears to be understating inventory by approximately $100,000. Fleet has a practice of returning inventory to stock or adjusting inventory quantities at a unit price of zero which has inadvertently lowered the carrying value of inventory on hand. As a result, the current inventory carrying balance is understated and future expenditures including Interdepartmental Requisitions and Invoice billings (IRI) are understated.
- Fleet is not completely recording all unused parts, tools, and supplies in its inventory balance. The audit obtained evidence that Fleet has an off-the-books inventory of spare parts. The items are commodity parts that were requested as a special order, not placed on the vehicles, and stored in the stockroom with the other inventoried parts. The audit found that when those spare parts were used, special order purchases were generated to replenish the stock of those spare parts; however, those purchased items were again excluded from inventory records. The audit could not quantify the amount of items that are currently excluded from inventory.
- Unknown or unreconciled differences are recorded each month between the FMIS reporting system and Fleet's inventory system. The differences fluctuate each month and can swing both positive and negative. For 2010 and 2009, the unknown or unreconciled difference was a positive difference of $70,000 and $42,000, respectively. A positive difference means that the FMIS reporting system is higher than Fleet's inventory system and indicates that the City has either paid for inventory that was not received into Fleet's system or inventory activity that decreased the balance at Fleet was not accurately captured in the FMIS reporting system. The audit could not determine the extent to which either or both of these factors cause the variance.
- **The audit makes three recommendations to improve Fleet's accuracy of inventory records that: 1) establishes a process for getting current inventory records accurately valued; 2) eliminates all "off-the-books" inventory to reduce potential theft, loss and waste; and 3) redesigns the inventory**

reconciliation process to place a greater emphasis on the Fleet inventory system activity, as discussed on pages 8 to 13.

- DPW implementation of other related Fleet inventory recommendations below is also essential to the maintenance of accurate, up-to-date inventory records. These related recommendations focus on developing revised inventory control procedures for all purchases and exception transactions (vendor returns and returns to stock, defective items, etc.), together with preparation of appropriate inventory valuation procedures. The audit also suggests certain improvements to the Fleet inventory physical security environment.

Internal Control Policy and Procedures

DPW's inventory internal control policy and procedures generally provide sound guidance to the divisions to develop strong internal control in the areas of physical security and inventory accounting and transaction documentation. The audit found that the DPW policy could be improved to clarify the definition of inventory and provide guidance over the purchase of inventory.

The audit disclosed that Fleet has not sufficiently implemented all aspects of the DPW current inventory policy and procedures. Internal control weaknesses were identified. Specific findings include:

- Overlap in job responsibilities within the inventory process which allows multiple individuals to process an inventory transaction from start to finish.
- Inconsistent documentation of inventory transactions including proper authorization for stock returns, inventory transfers, and manual adjustments to inventory.
- Ineffective cycle count process due to non-compliance with DPW inventory policy.
- Excessive use of manual adjustments to Fleet's inventory balance and the lack of management oversight over these adjustments.
- **The audit makes five recommendations to improve Fleet's internal control policy and procedures that: 1) expands purchasing guidance in DPW policy to include both inventoried items and items ordered on a special need basis; 2) clarifies DPW inventory definition to establish when commodities are to be recorded as inventory; 3) requires formalized and documented inventory**

procedures by Fleet; 4) eliminates or reduces the overlap in job responsibilities within the Fleet inventory process; and 5) enhances Fleet's internal controls over manual adjustments, as discussed on pages 13 to 17.

Physical Security

The audit generally found good physical security controls with some improvement needed over the inventory access controls. Specific findings from the audit include:

- The majority of Fleet's inventory is stored within locked stockrooms and Fleet has installed key card access to a substantial number of entry points at its warehouse locations.
- Access to the locked central stockroom appears excessive and the individuals with access do not appear to need 24/7 access given their job responsibilities. The audit disclosed that 58 individuals have access to the central stockroom and of that number only 11 of the individuals are inventory parts staff. The remaining individuals consist of fleet management, field repair service staff, DPW facility maintenance, IT support, and DPW operations management.
- The benefit of the key card access has been rendered obsolete at two locations because keyed doors have not been properly restricted. Nine individuals at the central stockroom have keys to the non-key card doors despite having key cards. All employees at the tire shop, including repair and service personnel, have keys to the non-key card door.
- The satellite locations have key card access to the warehouse itself but still have only a keyed door to the stockroom. Therefore, during the second shift, the stockroom is left open and the repair crew have open access to the items without inventory personnel on site.
- **The audit recommends that Fleet improve physical security by enhancing its inventory access controls as discussed on pages 17 to 19.**

Inventory Management

The findings discussed above indicate insufficient management reporting and oversight within DPW and Fleet management over inventory. The audit disclosed the following findings:

- The current reporting as prepared by DPW management does not adequately monitor Fleet's compliance with existing DPW inventory internal control policy and procedures.
- DPW management was unaware of poor inventory practices occurring at Fleet, including: 1) returning inventory or adjusting inventory at a unit price of zero; and 2) maintaining an "off-the-books" inventory of spare parts.
- DPW has not analyzed Fleet's inventory stocking practices and evaluated whether operational efficiencies could be made by changing the current stocking practices.
- **The audit makes two recommendations to improve management reporting and oversight that: 1) re-evaluates Fleet's inventory requirements for operational efficiencies; and 2) develops new Fleet monitoring tools and reports, as discussed on pages 20 to 23.**

B. Accuracy of Fleet Inventory Records

Accurate inventory records and reporting assist management in a variety of ways. Historical inventory purchases and disbursements allow management to budget for future repair and maintenance costs. Current inventory transaction activity allows Fleet management to replenish key inventory parts so that there is minimal delay in repairing vehicles and equipment critical to the City. Accurate inventory reporting also prevents excessive spending on parts already on hand and identifies slow-moving or obsolete parts that should be disposed of. The audit tested the accuracy of Fleet's inventory records and reports and deficiencies were found.

Inconsistent or Lack of Proper Commodity Recordkeeping

Approximately half of Fleet's commodity parts, tools, and supply purchases are considered non-inventory and are made on a special order basis. These special order purchases consist of specific commodity parts purchased to repair a fleet vehicle or equipment, common or frequently used consumable items such as oil, and other supplies that are indirectly related to a repair work order. In 2010, Fleet made $1,945,000 in non-inventory or special order commodity part purchases. Approximately $1,297,000 was for equipment commodity parts, $340,000 was for consumable items, and $308,000 was for other indirect supplies.

The cost associated with non-inventory special order purchases is expensed primarily to the Tools and Machinery Parts account through a direct charge to a work order generated at time of repair, or an indirect charge to a work order through a standard overhead rate. It is appropriate to directly expense these items if they are purchased and immediately used or if the cost to maintain a record of the commodity part in the inventory system is greater than the risk of losing the item to theft or excessive use. However, the audit found that not all of these special order parts and supplies are directly installed or used at the time the equipment is repaired, and the types of items purchased do not appear different or less valuable than other parts that are in inventory. In fact, the audit observed that some of the unused special order parts are stored in the locked stockrooms among inventoried parts, and in the case of many consumable parts, are stored in a secured room because they are considered high-risk for theft. Despite the similarity to inventoried parts, the audit found inconsistent or no recordkeeping on the uninstalled special order parts. The audit was unable to identify the number of these unrecorded spare parts, but did observe carts full of unrecorded parts.

Not recording special order stock on-hand could lead to inaccurately budgeting and over-spending for additional parts that are already on hand. This also increases the risk of unauthorized removal of inventory, since there is no record of the item. Overall, the audit found poor internal controls over the purchase and receipt of the special order parts, which increases the risk of items being purchased and received without proper authorization and verification.

Consumable items are recorded in the inventory system on a quantity basis so that levels can be tracked and replenished appropriately. However, the consumables are recorded at a zero price, thereby understating the actual balance of inventory by approximately $100,000. Since Fleet is treating the consumable items as inventory, they should be recorded at the actual carrying value.

Inaccurate Inventory Pricing

The City's policy is to value its inventory at a moving average price. As inventory is purchased, the moving average price is adjusted to reflect the current purchase price. The audit obtained evidence that Fleet incorrectly adjusted the moving average price per unit

by returning unused inventory to stock at a unit price of zero, which inappropriately lowers the average moving price of the item. The audit tested a sample of 20 inventory items adjusted inaccurately and compared their current carrying price to the most recent invoice price. In all cases, the carrying price after the manual adjustment was less than the most recent invoice price. See Table 1 for a sample listing of parts and the difference between the current carrying price and the most recent invoice price.

Table 1: Inaccurate Fleet Inventory Pricing Sample

Part Number	Part Description	Carrying Price	Purchase Price	Amount Below Invoice	Percent Below Invoice
83001044	KNOB HEATER	$5.23	$8.89	-$3.67	-41.2%
37001005	BREAKER 20A	4.95	6.83	-1.88	-27.5%
34012007	FLASHER 12V	8.02	14.71	-6.69	-45.5%
34015004	SWITCH	6.55	13.77	7.22	-52.4%
15009020	ARM IDLER	35.84	50.39	-14.56	-28.9%

*Carrying price obtained from Fleet during audit in September 2010
**Most recent purchase invoice price as of September 2010

The moving average price can affect accurate financial reporting in three ways.

- *Current carrying value*: The carrying value of inventory on hand is based on the current moving average price. Therefore, the City's inventory assets for Fleet appear to be understated as a result of the inaccurate manual adjustments. The audit was unable to quantify the total understatement of inventory value. However, an audit sample revealed that 339 parts had a stated carrying price averaging 24 percent below the carrying price before the adjustment.
- *Reported expenditures by both Fleet and other departments:* Fleet does not incur an expense until the item is actually disbursed from inventory for use, at which point the moving average cost is used in determining the total expenditure. Therefore, Fleet's inventory expenditures will be understated. Fleet performs repair services to a variety of departments including Library, Health Dept, Police Dept, Water Works, Sewer Maintenance Fund, and Parking Fund. When repair services are performed, an Interdepartmental Requisition and Invoice (IRI) is created to bill the department for the work performed based on the moving average cost of parts used. As a result of the manual adjustment, the IRI's are inaccurate and most likely understated.
- *Budgeted expenditures by both Fleet and other departments:* Budgeted expenditures are based on historically reported information which currently appears to be inaccurate. Therefore, the City's budget for future equipment repair

and maintenance costs may be understated.

Unknown Differences in Reporting of Inventory

Accurate inventory reporting is dependent on information getting transferred from the Fleet Focus inventory system to the City's FMIS financial reporting system. While the other DPW divisions utilize an inventory module within the FMIS, the Fleet Focus is a separate inventory system not integrated with the FMIS. All data is transferred to the FMIS manually, therefore, a manual reconciliation is necessary to ensure that the FMIS is accurate. This dual system of recording inventory data substantially increases data entry costs while exposing the City's FMIS financial system to incorrect, inconsistent fleet inventory data.

DPW reconciles its Fleet system with the FMIS, monthly. However, the audit found that these reconciliations are not complete and always indicate some amount of unknown difference that varies from month to month. At year end 2010, the unknown difference reported by DPW was approximately $70,000 and at year end 2009 it was approximately $42,000. According to DPW, the following factors make reconciliation between the systems difficult.

- Timing delays in processing vouchers and paid invoices which are the basis for recording the purchases received into inventory into the FMIS;
- Timing delays in the recording of journal entries in the FMIS for inventory disbursement activity;
- Timing differences in the reports generated from the Fleet system and FMIS, resulting in an inconsistent cut-offs on inventory receipt and disbursement activity;
- Manual adjustments transactions recorded in either the Fleet system or FMIS but not in both.

To address the timing issues related to the receipt of inventory, DPW established a new process in early 2010 to manually match the individual receipts reported from Fleet with the purchase vouchers processed in FMIS. While this procedure benefits the reconciliation process, there still remains an unknown difference and the FMIS is not fully reconciled at year end.

Leaving variances between the Fleet inventory system and the FMIS general ledger unresolved prevents management from adequately monitoring Fleet's inventory activity and ensuring that errors or irregularities are not occurring. Given that there are so many factors that could result in a reconciliation variance, transaction errors may not be distinguishable from transaction record timing delays. Due to the significant number of transactions occurring, the current process as designed most likely would not identify all errors. Therefore, there is risk that the City is paying for items that were never received or were unauthorized purchases.

If transaction recording timing differences cannot be resolved, DPW may need to monitor Fleet's activity a different way by focusing on the Fleet inventory system rather than the FMIS. DPW and Fleet's first focus should be to get all the information accurately into the Fleet inventory system and then adjust the FMIS general ledger system at the end of the year to the inventory system.

A different reconciliation that focuses on the inventory system sub-ledger activity and a focus on matching receipts processed in Fleet Focus against processed vouchers may be more effective at monitoring Fleet's activity and identifying errors.

Recommendation 1: Improve accuracy of Fleet inventory values

Fleet should take the following actions to improve the accuracy of its inventory values.

- Establish a process for assigning dollar values to the consumable inventory currently recorded in the inventory system that reflect an accurate moving average price.
- Establish a process for evaluating the moving average prices of current inventory on hand to ensure that they are appropriate.

Recommendation 2: Eliminate all "off-the-books" inventory

Fleet should establish a process for identifying and recording all spare parts within the inventory system at accurate moving average prices in order to reduce the risk of potential theft, loss and waste.

Recommendation 3: Redesign inventory reconciliation process

The current monthly reconciliation of Fleet inventory system transaction balances with the FMIS financial reporting system does not capture enough information to identify all variances and does not result in corrective entries to the financial records. DPW should ensure that all Fleet inventory transactions are processed accurately and completely in the Fleet Focus system, so that its balances are reliable for reconciliation with the FMIS. DPW should work with the Fleet inventory manager to obtain monthly reports of the key activity occurring that could then be analyzed monthly. Once DPW and Fleet is comfortable that the Fleet Focus system is accurate and complete, DPW should continue with a thorough reconciliation as of year end, after all voucher and journal entry activity has been finalized, which adjusts the FMIS system to the Fleet Focus system.

See Appendix A for additional detailed recommendations for the reconciliation process.

C. Fleet Inventory Internal Control Policy and Procedures

Internal controls assist management in accomplishing its business objectives and meeting its responsibilities by reducing the risk of errors and irregularities. Internal controls provide assurance that data and information are accurate, complete and reliable. Management has a responsibility to design and implement appropriate control-related policies and procedures to reduce errors and mitigate risks. The audit evaluated DPW's department-wide inventory policies and procedures and their implementation by Fleet.

DPW Inventory Policy

DPW has formally documented its inventory internal control policy and procedures, which generally provide good guidance to its divisions, in the areas of physical security, inventory accounting, and transaction documentation. The audit found that the DPW policy could be improved by the following:

- Eliminate all "off-the-books" inventory. Extend current policy and procedures to cover all commodity parts, tools, and supply purchases. The current policy applies only to those parts and commodities purchased with the inventory budget, but not with the operating budget. This has resulted in entirely different

procedures for special order parts, tools, and supplies purchased with operating budget appropriations. The audit found significant weaknesses for these operating budget special order purchases, including missing documentation and an informal purchase and receipt process. The policies and procedures could be made applicable to all purchases that exceed a certain dollar, quantity, or other measurable threshold. See Appendix B for specific testing and findings.

- Expand the policy to better define when purchased parts should be recorded in inventory. The policy needs to provide guidance on the type of parts that should be stocked (and recorded) in inventory versus purchased for immediate use.

Fleet's Implementation of DPW Inventory Policy

The audit evaluated and tested Fleet's procedures and internal controls for routine inventory transactions. The audit reviewed the Fleet Focus inventory system and a sample of system-generated reports for accuracy and completeness. The audit checked a sample of 30 inventory receipts, 30 inventory disbursements and attempted to test 10 stock returns and 10 inventory transfers. The audit also reviewed Fleet's process for performing physical inventory counts by performing a walk-through with Fleet inventory personnel. The audit made the following positive observations regarding Fleet's procedures and internal controls:

- Fleet's inventory system has the ability to provide thorough inventory records for all types of inventory transactions including purchasing, receiving, disbursement, transfers and stock returns.
- Fleet was able to provide detailed listings and reports of inventory on hand, inventory and special order purchases made during a given period, and adjustments to inventory.
- Inventory receipts are electronically matched against the system-generated purchase order and a review of the receipt information against the vendor invoice to ensure accuracy is performed daily.
- Inventory disbursements are well documented and appropriately authorized by repair supervisors.
- Fleet personnel who perform the cycle count were knowledgeable of the commodity parts that they were counting and were very familiar with the layout of each stockroom.
- Fleet is timely performing the cycle count and is maintaining the necessary

documentation to support that the count was performed.

In spite of the strengths noted, the audit disclosed that Fleet has not sufficiently implemented essential components of the DPW inventory policy and noted the following deficiencies related to procedures and internal controls:

- The monitoring of inventory receipts and the authorization of the invoice for payment is executed by the same individual who purchases inventory. This lack of separation of duties exposes the subject inventory to potential for undetected loss or theft and as such is an important internal control deficiency.
- Access to transaction screens within the inventory system has not been properly restricted based on job responsibilities. The audit observed an overlap in responsibilities within the Fleet inventory personnel. Specifically, 12 individuals have the ability to create a work order, purchase inventory, receive inventory, and disburse inventory within the inventory system. See Appendix C for detailed recommendations.
- Fleet is not consistently documenting all types of inventory transactions and ensuring that each transaction contains the necessary approvals and signatures required by the DPW inventory policy. Currently, Fleet has a separate form for inventory disbursements, a form for inventory stock returns, but no formal forms for stock transfers and manual adjustments. See Appendix C for specific testing and findings.
- Cycle count procedures are not performed in accordance with the DPW inventory policy, limiting the effectiveness and reliability of the cycle count process, and thereby delaying the identification and correction of potential inventory problems. See Appendix D for specific testing and findings.
- Fleet processed over 5,000 inventory transactions using manual adjustments rather than through normal inventory processing. The DPW inventory policy calls for manual adjustments to be used on an exception basis when correction cannot be made by reversing or re-processing of the original transaction. The audit analyzed the types of manual adjustments performed by Fleet and found the most common reasons for the adjustments were quantity adjustments identified outside of the cycle count process, stock returns, and adjustments to the receipt cost. Fleet management is not properly authorizing these adjustments and adjustment access has been granted to eight individuals.

Recommendation 4: Expand purchasing guidance in DPW policy

Regardless of whether the part is installed on a piece of equipment or stored in the stockroom, good control of the part is necessary from the time it is ordered to the time it is installed on the equipment. Accordingly, the DPW inventory policy should be expanded to address the early identification and control of all parts/items at or soon after the point of purchase. The resulting procedures could be limited to purchases that exceed a dollar, quantity, or other measurable threshold based on DPW's discretion.

Recommendation 5: Clarify DPW definition of inventory

The DPW policy should provide clear and specific guidance over what types of items should be carried as inventory versus treated as a supplies expense. This determination should be based on a measurable criteria.

Recommendation 6: Formalize and document Fleet procedures

The DPW inventory policy provides sound guidance to Fleet on proper procedures and internal control. However, it is a high level policy under which Fleet should develop detailed procedures related to its specific operations to facilitate proper implementation of this policy. See Appendix C for detailed recommendations on implementing the DPW Policy by Fleet.

Recommendation 7: Reduce overlapping job responsibilities

Fleet should review the job responsibilities related to each step of an inventory transaction and attempt to reduce or eliminate responsibilities that overlap. One person should not have access to control an entire inventory transaction, since this increases the risk of transaction errors or thefts. The Comptroller's Office can assist DPW in evaluating job responsibilities, but in any event the process should consist of the following:

- Ensure key inventory activity is properly segregated, particularly in the areas of purchasing, receiving and recording inventory, creating work orders and disbursing inventory.
- Remove system access that is not necessary to complete the assigned task. Inventory personnel should generally not have access to the work order module.

In areas where separation cannot occur, management should provide more extensive oversight to ensure no inappropriate activity is occurring.

Recommendation 8: Enhance controls over manual adjustments

Manual adjustments can reverse transactions and adjust the quantity and price of inventoried items, thus increasing the risk that an individual could use such adjustment to cover or hide transaction error or theft. Fleet should follow the DPW inventory policy and establish tighter control over the use of manual adjustments to inventory and limit their use to exceptions, not routine transactions. See Appendix E for detailed recommendations regarding controls over manual adjustments.

D. Fleet Inventory Physical Security

The audit evaluated and tested Fleet's inventory physical security and found the following positive physical security controls:

- The majority of inventory is stored in locked stockrooms.
- Key card readers have been installed on many points of entry to the Central Garage stockroom and the office that leads to each stockroom at the satellite locations.
- Fleet is performing a weekly review of after-hour access to the Central Garage stockroom.
- Fleet is performing the semi-annual security review checklist in order to identify problems with stockroom, storage yards, and overall facility security.
- Fleet is performing an annual review of the listing of individuals with access to the Central Garage stockroom.

To improve physical security, the audit found that inventory access controls need to be

stronger. The audit disclosed that a significant number of employees have access to the stockrooms and in many cases, the access did not appear necessary to perform the employees' job functions. Physical security at the satellite locations posed an even greater risk of unauthorized or unobserved removal of inventory because the satellite locations are not managed by inventory personnel during the shift of operation and after-hour access is not properly monitored. In addition, Fleet has installed key card access to many of its stockroom points of entry, however, the benefit has often been rendered obsolete because access to the keyed doors are not properly restricted.

Central Stockroom Access

The majority of Fleet's inventory is stored at the Central Garage and Fleet has secured most commodity parts within the locked stockroom. Key cards have been installed on most of the doors and after-hour logs are properly monitored. However, the number of individuals with access to the Central stockroom appears excessive and it does not appear that divisional management is critically evaluating the number of individuals on the list and whether their access is necessary to perform the job function. The audit disclosed that 58 individuals have access to the Central Garage stockroom and only 11 of those individuals are actually stockroom parts staff. The remaining individuals consist of various fleet management, field repair service staff, DPW facility maintenance staff, IT support, and DPW operations management.

Access to the stockroom should be limited to those individuals who require access to perform their job function. Proper segregation of duties separate those who use the inventory to perform the repair or service from those who manage the inventory. In order to maintain proper segregation of duties, only individuals that need access to perform their job function should have access to the stockroom. Improper segregation of duties can lead to unauthorized or unobserved removal of inventory.

It was further noted that of 58 individuals with access, 48 have 24/7 access to the Central Garage stockroom. There is a higher risk of unauthorized or unobserved removal of inventory during after-hours because individuals responsible for managing inventory and ensuring each transaction is documented are not on hand. While an after-hour log is monitored, a stronger preventative control would be to only grant access during the time needed to perform the job function.

Satellite Stockroom Access

The satellite locations do not have key card access on the stockroom doors. During the 2nd shift, the door to the stockroom is open and the repair crew has open access to the items. There are no parts clerks on duty to assist in proper physical control of the inventory. In addition, Fleet does not currently maintain an after-hour log at the satellite locations. Therefore, the satellite locations pose a high risk for unauthorized or unobserved removal of inventory.

Inconsistent Key Card Installation

The audit identified two locations where key card access had only been installed on some of the doors.

- In the case of Central Garage, three out of seven points of entry had key card access. The remaining doors were restricted by keys, however, nine individuals had a key to the remaining four doors.
- In the case of the Tire Shop, there are three points of entry and only one door is key card restricted. At the Tire Shop, all of the inventory is stored on the floor of the workshop so once access is granted, an individual has access to all tire inventory. Six repair and service personnel have both key card and keys to the three doors at the Tire Shop.

The advantage to the key card reader is that you can monitor who accessed the stockroom and at what time they accessed it. At Central Garage, the audit found that all of the nine individuals that have a key, already have access via key card. At the Tire Shop, the benefit provided by the key card access is rendered obsolete because all of the staff have keys to use the other doors.

Recommendation 9: Improve physical security

Fleet should improve physical security by enhancing its inventory access controls as detailed in Appendix F.

E. Fleet Inventory Management

Once management establishes policy and procedures to mitigate a business process risk, it is management's responsibility to monitor them to ensure that they are implemented as designed and operating effectively, as well as resolve problems identified by the controls.

DPW management has not provided adequate oversight over Fleet's inventory activity and related internal controls. Fleet's established procedures are not in compliance with the DPW Inventory Policy and the current reports and tools used by DPW management are not adequately designed to identify non-compliance. The DPW inventory policy is a high level policy that provides good guidance to the divisions, but it does require the divisions to implement more specific procedures and internal controls unique to their transactions. Fleet has not formally documented its procedures and practices which prevents DPW from ensuring the procedures are in compliance.

The audit identified two major Fleet Services inventory management weaknesses which continued without knowledge of the department's inventory manager. The first instance was the practice of returning inventory or adjusting inventory at a unit price of zero and the second instance was the practice of maintaining an off-the-books inventory of special order spare parts. The audit learned of both practices through observation of stockroom activity and inquiry with Fleet inventory personnel.

Another area worthy of greater management oversight concerns Fleet inventory stocking practices. The DPW inventory policy defines inventory as materials purchased in advance of needs, advantageously kept on hand and replenished in appropriate quantities because they are critical to the department's mission and are either difficult to obtain on short notice or are purchased in larger quantities for pricing and/or logistical advantage. DPW has not evaluated whether Fleet's stocking practices are consistent with this policy.

Although the audit did not evaluate or test the operational efficiency or benefit of maintaining Fleet inventory, the audit did perform a high level analysis of Fleet's inventory on hand, inventory disbursed, and special order purchases. An analysis of Fleet's Central Garage inventory as of August 31, 2010 showed that approximately 76 percent had a unit cost of less than $5 and constitutes only 5 percent of Fleet's total

inventory carrying value. The most significant share of the carrying value, approximately 44 percent, consist of items with a unit price greater than $100, but these items account for only 2 percent of the total inventory quantity on hand. Fleet is apparently expending resources to manage and maintain a significant number of inventory parts that make up only a small percentage of Fleet's inventory carrying value. See Table 2 for Fleet Central Garage inventory statistics as of August 31, 2010.

Table 2:Fleet Central Garage Inventory Statistics as of August 31, 2010

Unit Price	Commodity Parts		Quantity on Hand		Carrying Value	
< $1	751	14%	38,802	55%	$ 5,201	1%
$1 - $5	1,044	20%	14,767	21%	35,972	4%
$5 - $10	741	14%	4,913	7%	35,280	4%
$10 - $20	730	14%	3,518	5%	50,821	6%
$20 - $60	1,095	20%	5,689	8%	216,917	27%
$60 - $100	371	7%	1,484	2%	112,325	14%
> $100	589	11%	1,215	2%	346,344	44%
Total	5,321	100%	70,388	100%	$802,860	100%

An analysis of Fleet's inventory disbursed during calendar year 2010 shows that the majority of the disbursed parts on a quantity basis is again the items with a unit price of less than $5. In 2010, 78 percent of the inventory disbursed to repair and maintenance work orders consisted of commodity parts with a unit price of $5 or less for a total decrease in inventory carrying value of $70,910 or 3.4 percent of the total inventory disbursed. See Table 3 for Fleet 2010 inventory disbursements.

Table 3: Fleet Inventory Disbursement Statistics for 2010

Unit Price	Disbursed Inventory Quantity		Disbursed Inventory Dollar Value	
< $1	90,243	61%	$ 7,633	0.4%
$1 - $5	25,132	17%	63,277	2.6%
$5 - $10	8,010	5%	56,519	3.0%
$10 - $20	6,154	4%	87,604	5.0%
$20 - $60	9,569	6%	356,053	19.0%
$60 - $100	4,492	3%	340,389	18.0%
> $100	3,909	3%	944,130	51.0%
Total	147,509	100%	$1,855,606	100.0%

In addition, the audit further notes that based on an analysis of Fleet's special order purchases directly associated with equipment work orders, Fleet is still making a

significant number of low dollar purchases on a just-in-time basis. During 2010, 44 percent of the quantity of special order parts purchased consisted of parts with a per unit price of less than $5. The total cost to purchase these small dollar parts was only $18,078 or 1 percent of total special orders purchased. See Table 4 for Fleet 2010 special order purchases associated directly to an equipment or vehicle.

Table 4: Fleet Direct Special Order Purchases Statistics for 2010

Unit Price	Quantity Ordered		Cost of Order	
< $1	5,076	21%	$ 2,453	0.2%
$1 - $5	5,557	23%	15,625	0.8%
$5 - $10	2,686	11%	19,060	1.0%
$10 - $20	2,375	10%	33,946	3.0%
$20 - $60	4,178	17%	153,514	12.0%
$60 - $100	1,758	7%	135,022	10.0%
> $100	2,656	11%	936,354	72.0%
Total	24,286	100%	$1,295,974	100.0%

Recommendation 10: Re-evaluate Fleet inventory needs

DPW and Fleet management should re-evaluate its inventory requirements, to determine if operational efficiencies could be made through establishing a more just-in-time approach for purchasing parts, tools, and supplies, and consolidating and eliminating inventory locations at Fleet or among the other DPW divisions. Significant efficiencies may be possible, given the estimated low 1.1 inventory turnover rate and huge quantities of low unit price items found at Fleet. Streamlined City purchasing policies and use of the purchasing Procard may facilitate more frequent just-in-time purchasing. The Department of Administration Budget Office and the Comptroller's Office may be able to assist DPW with this study.

The audit did not evaluate the stocking practices at the other DPW divisions that store inventory. However, given the inventory audit findings at Fleet, DPW should consider this recommendation department-wide.

Recommendation 11: Develop new monitoring tools and reports

Once Fleet has formalized and documented its inventory procedures, as discussed in Recommendation 6, DPW should develop additional monitoring tools and reports to ensure Fleet's inventory transactions were processed accurately and in compliance with Fleet and DPW policy and procedures. The Comptroller's Office can assist DPW in establishing new tools and reports, but the process should address the following:

- *Key activities to be monitored:* Examples might include: inventory receipts versus processed vouchers, inventory disbursements versus processed work orders, and frequency and reason for manual adjustments.
- *Performance standards and benchmarks:* DPW should identify appropriate standards and benchmarks for analyzing the information in order to assist management in identifying inaccuracies or inconsistencies at the divisional level Is there an historical monthly trend? Can information be compared against other divisions? Does a ratio analysis need to be created?
- *Party performing the monitoring:* DPW should designate the manager responsible for monitoring the process, such as the DPW inventory manager or Fleet inventory manager.
- *Reports used for monitoring:* DPW should develop appropriate monitoring tools and reports. These reports should be designed to properly match the level of manager responsibility by incorporating a "drill down" of information to provided additional detail data (or "roll up" summary), as needed.
- *Monitoring frequency:* DPW should specify a monitoring report schedule, such as monthly, quarterly, or annual reporting.

Enhancing the Reconciliation Process

The current reconciliation process results in a monthly plug each month between the inventory system and the general ledger. Given the challenges of getting all information into the FMIS general ledger, DPW should place greater emphasis on getting the Fleet inventory system sub-ledger accurate and develop tools to reconcile the activity posted in the inventory system to what is posted in the general ledger system. As such, the audit makes the following detailed recommendations:

RECOMMENDATION A1: All activity that affects the inventory balance should be first reported in the Fleet inventory system and than a process should be established as to how the activity will get reported in the FMIS general ledger system (i.e. through an IRI or other journal entry).

RECOMMENDATION A2: Given timing delays of activity hitting the FMIS general ledger, DPW should re-evaluate how it monitors the Fleet inventory balance to ensure the inventory system is accurate versus simply comparing the inventory system to the general ledger system. If the FMIS general ledger system is not current, the reconciliation cannot timely identify inaccuracies for investigation and correction by management.

RECOMMENDATION A3: DPW management should establish reporting requirements to assist in proper cut-off of information being entered into the Fleet inventory system. Examples may include cut-off guidelines for entering receipts and adjustments into the Fleet inventory system sub-ledger at the end of each month, specific reporting requirements over receipt activity, and guidance over the timing of when inventory value reports are to be generated each month.

RECOMMENDATION A4: DPW should continue to perform an annual comparison of the FMIS general ledger system to the Fleet inventory system at the end of each fiscal year and after all activity has been processed to the general ledger. Once the Fleet Focus inventory system has been determined to be accurate and complete, an adjusting entry should be posted to the FMIS general ledger system to bring the two systems in balance with each other.

RECOMMENDATION A5: Fleet should develop a process to batch its invoices in

groups that match the receiving report generated out of the Fleet inventory system. Establishing a daily receipt log that ties to the batches of invoices, would allow management to identify those receipts or invoices which have not been processed for payment and therefore have not hit the general ledger.

RECOMMEDNATION A6: The DPW inventory manager should utilize the system generated reports and queries from Fleet staff when preparing the monthly reconciliation as it provides stronger support for the balances being analyzed.

Lack of Policy and Procedures for Special Order Purchases

The current DPW policy and procedures does not provide guidance over internal controls and proper transaction documentation for special order commodity part purchases. The audit documented and tested the current process for special order transactions and concluded that the internal controls surrounding these purchases lacked proper documentation over the purchase and receipt of the commodity part and the process did not allow for the addition of the part to inventory when not timely installed on the vehicle or equipment. The audit disclosed the following deficiencies as it relates to the special order purchases:

- The tracking of special order purchases is very informal. There is no electronic purchase order created. Rather, a special order parts pick-up tag is manually filled out at time of purchase. The pick-up tags are not pre-numbered, are not logged or tracked but are simply placed in a card box that sits on a counter in the stockroom at Central Garage.
- The tracking of the receipt of the special order item is also informal. When an item is received, the receiving clerk is to manually match the packing slip or the invoice to the parts pick-up tag. There is no log or entry into a system that the item was ever received.
- Since Fleet does not record the receipt of the item, there is no process for maintaining a record of special order items that don't get directly installed. Fleet assumes that all items received get directly installed on the equipment and therefore, immediately expensed to the work-order. However, as discussed earlier, the audit obtained evidence that not all parts are directly installed.
- There is inconsistent and/or missing documentation over the transaction. Out of a sample of 30 special order purchases, the audit noted the following discrepancies:
    - There were 26 purchases where the parts request form called the ME- 97 could not be found. Therefore, no documentation supporting the repair supervisor approval of the part request that led to the special order purchase.
    - There were 16 purchases where no parts pick-up tag could be found. Therefore, no documentation supporting that the item was actually received and reconciled to the invoice.
    - There were 13 purchases where neither the ME-97 nor the parts pick-up tag could be found. Therefore, no documentation supporting the appropriateness, authorization, or receipt of the item.

Given the significant amount of special order purchases occurring at Fleet, an increased emphasis should be placed on establishing policy and procedures that ensure proper documentation, authorization, and tracking of unused special order parts. Establishing good procedures and internal control will reduce the risk of unauthorized purchases, purchases recorded but parts not received, and purchases made but not recorded. Therefore, the audit has the following specific detailed recommendations:

RECOMMENDATION B1: Fleet needs to review the current process for acquiring special order commodity parts and implement internal controls over purchasing, receiving, tracking, and disbursing of the parts. Regardless of whether the part is installed on a piece of equipment or stored in the stockroom, there needs to be good control of the part from the time it is ordered to the time it is installed on the equipment.

RECOMMENDATION B2: Fleet should utilize its inventory system for tracking the purchase, receipt, and direct issue of the special order part because the system lowers the risk of the transaction being processed without sufficient documentation or support. The audit reviewed Fleet's inventory system manual and noted that the system has the capability to place special order purchases in the quick order screen and make a direct issue to the work order. Utilizing the inventory system to process significant special order purchases would minimize the risk of transactions being undocumented or unsupported.

RECOMMENDATION B3: All significant commodity part purchases not directly installed on an equipment or vehicle need to be recorded into the inventory system so that there is proper documentation and control over the item.

Internal Controls for Accounting and Transaction Documentation

The audit reviewed and tested internal controls over routine inventory transactions including the receipt of inventory, disbursement of inventory to a work order, and inventory transfer and stock returns. The audit also documented Fleet's use of the inventory system to process its routine transactions noting that Fleet is using its inventory system for all commodity parts that it considers inventory. The audit discovered that Fleet has not adequately implemented the DPW policy and procedures governing proper internal controls and documentation of inventory transactions such as receipts, disbursements, returns, and adjustments. Section 5 of the DPW inventory management policy and procedures provides guidance over general inventory accounting and transaction entry and documentation requirements. The weaknesses found, as it relates to routine transactions, primarily relate to the underlying documentation for each transaction and the timely and complete recording of the information into the system. Specific findings include:

- Receipt of Inventory: Fleet's inventory system has a good control governing the receipt of inventory because the receipt must be matched to the purchase order before it can be received in the system. The audit tested a sample of 30 inventory receipts that were received and found proper documentation supporting the purchase and receipt. The audit observed the following weaknesses regarding receipts:
    - Not all commodity parts require a purchase order (i.e. special order parts) and there is no restriction over who can create a purchase order and who receives the inventory. Therefore, the control is not as effective because parts can be purchased and received outside of the inventory system.
    - The management review and invoice authorization control that manually compares the receipt report to the actual invoice before payment approval is performed by the same individual who purchases the inventory and who has access to receive, disburse, and adjust inventory. As discussed under proper segregation of duties, one person should not have the ability to process a transaction from start to finish.
    - Despite the controls over receipts when entered into the Fleet inventory system, the audit was unable to reconcile the receipt report generated out of the Fleet inventory system to the receipts processed into the general ledger. The current report prepared out of the Fleet inventory system has

an error that results in adjustments to inventory receipts not being accurately updated.

- The audit found that the receipt of inventory recorded in the general ledger is based on processed vouchers rather than data from the Fleet system. To ensure inventory is stated properly, the inventory receipts between the two systems should be compared for accuracy and completeness. However, given the error in the Fleet receipt report, this comparison is difficult to perform.

- Disbursement of Inventory: Inventory disbursements are requested through a Fleet standard form called the ME-97 and it requires the repair supervisor to approve the disbursement, which is a good control. The audit sampled 30 inventory disbursements and found two instances where the ME-97 could not be found. The ME-97 form is not sequentially numbered which makes it harder for Fleet inventory management to ensure that all inventory disbursements are properly documented and approved.

- Transfer of Inventory and Return to Stock: The audit was unable to test internal controls over the transfer of inventoried parts or the process for returning parts to stock because Fleet's current process is very informal and is not properly documented. Since Fleet operates five stockroom locations, the transfer of inventory is a frequent process that should be formally documented and tracked so that accurate inventory levels can be maintained.

The risk of having inaccurate or incomplete transaction reports is that the City may be paying for items which have not been received or were received but not properly approved for purchase.

RECOMMENDATION C1: The inventory disbursement form could be enhanced by adding a sequential number to the form so that missing documents can be investigated to ensure that all inventory disbursement activity is completely recorded.

RECOMMENDATION C2: Fleet needs to develop a process for formally documenting inventory transfers and stock returns in accordance with DPW policy and procedures.

RECOMMENDATION C3: Fleet should evaluate the DPW standard inventory

transaction report to determine if it meets the needs of its common inventory transactions.

RECOMMENDATION C4: Fleet should review the reporting parameters set up in its inventory system for receipt reporting to fix any inaccuracies of actual activity. Linking this report to batched invoices sent over for invoice processing would allow for greater monitoring of receipt activity by the DPW inventory manager.

RECOMMENDATION C5: In connection with Fleet's review of proper segregation of duties, Fleet should ensure that individuals who perform the purchasing function are separate from the receipt function. In addition, the individual performing the purchasing should not also authorize the invoice for payment. Ideally, a manager should perform all significant purchases for payment.

Cycle Count and Variance Handling

Fleet has not adequately implemented the DPW policy and procedures governing the investigation and analysis of quantity variances identified through physical inventory counts. Section 6 of the DPW inventory management policy and procedures provides guidance to the division over proper procedures for conducting and verifying physical or cycle counts of inventory. Specific findings include:

- The personnel scheduling the cycle count are also the personnel performing the count rather than the manager per the DPW policy.
- Fleet is printing blind cycle count sheets, however, before entering the results of the count, the counter is looking up every inventory item and manually comparing the results to the count sheet. Therefore, the count is no longer blind and could therefore be falsified.
- The posting of the count is performed by the same person who performed the count, thus leading to improper segregation of duties. The audit further notes that the individuals performing the count have significant access to the entire inventory system.
- Correction activity is not being handled through the reversal/and or reprocessing of the original transactions. Rather, Fleet is using a manual adjustment without fully understanding the cause.
- Physical count adjustments identified outside of the cycle count process were not hitting the variance count but rather were adjusted manually and the audit did not obtain evidence that the manual adjustments hit the financial general ledger system.

The purpose of a cycle count is to verify the existence of physical assets and the completeness and accuracy of inventory records. As currently designed, the results of the cycle counts could be manipulated and lead to inaccurate and incomplete reporting of inventory. Therefore, the audit makes the following detailed recommendations over the cycle count process.

RECOMMENDATION D1: All physical count variances identified through the year during cycle count or other times should be documented and reviewed by the inventory manager. A quantity and dollar threshold should be established to give guidance over when a variance is investigated further.

RECOMMENDATION D2: All variances and adjustments should be recorded in a separate variance account in the general ledger.

RECOMMENDATION D3: Inventory management should develop the counting schedule to ensure that all parts are scheduled to be counted once a year.

RECOMMENDATION D4: Results from the cycle count should be entered blindly into the inventory system so that all variances can be system calculated. It is inefficient and weakens the control to manually check the inventory counts before entering the counts in the system.

RECOMMENDATION D5: A separate individual should be responsible for posting the results of the count as well as posting any adjustments to inventory. The individual who counts the inventory should not be responsible for posting the results.

RECOMMENDATION D6: A separate analysis of the satellite locations should be performed over whether periodic cycle counts versus a full physical is more appropriate. There is less monitoring of inventory transactions at the satellite locations and therefore, it may make more sense to perform a full physical count each year to get the inventory balances accurate at least once a year.

Enhance Controls over Manual Adjustments

Fleet should establish tighter control over the use of manual adjustments to inventory and limit their use to exceptions, not routine type transactions. To increase control over these adjustments, the audit makes the following detailed recommendations:

RECOMMENDATION E1: Fleet should limit the number of individuals that have access to post manual adjustments to a small number of individuals and establish a level of approval required before adjustments can be made. For example, adjustments to inventory prices should be restricted to appropriate users and for a justifiable reason.

RECOMMENDATION E2: Physical inventory adjustments should not be handled manually but should be processed through the inventory systems variance handling module.

RECOMMENDATION E3: Inventory quantity adjustments should not be added back at a zero cost. The adjustment should be to the quantity at the current moving average cost price.

RECOMMENDATION E4: All adjustments, manual or automatic, need to get recorded in the FMIS general ledger system.

RECOMMENDATION E5: The DPW inventory manager should review and analyze all manual inventory adjustments.

Physical Security Controls

Fleet has not adequately implemented section four of the DPW inventory management policy and procedures governing inventory access. Strong physical security controls mitigate the risk of unauthorized or unobserved removal of inventory. As such, the audit makes the following detailed recommendations over inventory access controls.

RECOMMENDATION F1: Fleet should remove stockroom access to any individual that does not regularly require access to perform their job function.

RECOMMENDATION F2: Temporary access (i.e. facilities maintenance and IT Support) can be granted, however, Fleet should develop a process for granting, monitoring, and removing the temporary access.

RECOMMENDATION F3: The satellite locations need to re-establish a process for documenting and monitoring the after-hour access that occurs. The process should be in accordance with the guidelines found within the DPW Inventory Management Policy.

RECOMMENDATION F4: Fleet should consider installing the key card system to the satellite locations so that the after-hour access log could be monitored.

RECOMMENDATION F5: Keys should be issued sparingly. If the individual already has access to stock room via key card, Fleet should determine if a key is still necessary for the other doors.

RECOMMENDATION F6: Fleet should consider installing key cards on any remaining unmonitored points of entry.

City of Milwaukee

Department of Public Works

Jeffrey J. Mantes
Commissioner of Public Works

Preston D. Cole
Director of Operations

June 8, 2011

Mr. W. Martin Morics
City of Milwaukee Comptroller
200 E. Wells St. Room 404
Milwaukee, WI 53202-3546

Mr. Morics,

Thank you for the opportunity to respond to your audit report "Audit of the Department of Public Works Fleet Services Inventory". Upon its review, I found it to be thorough and objective, offering several recommendations that are certain to improve the management, security and accountability of DPW's inventory of fleet parts and supplies.

As stated in your report, DPW's Fleet Services Section maintains over 4,000 vehicles and equipment used to provide a variety of city services, many of which are crucial to public safety. The importance of this task cannot be overstated, nor can the efforts of Fleet Services to accomplish this task each day of the year. Effective parts and supplies inventory management is an essential aspect of this. Fleet Service's inventory includes over 4,700 unique items totaling nearly 90,000 units stored at five repair garages. In a given year, Fleet Services inventory will record over 150,000 disbursements. Given the important function served by Fleet Services inventory and the breadth of effort it requires, DPW has given full consideration to each of the audit's recommendations for improvement.

Attached is a list of the audit's recommendations with DPW's response to each. Of the 42 recommendations listed, 31 have been implemented and 9 are being evaluated for implementation. The remaining two recommendations have been determined to require additional staffing resources that are not included in DPW's 2011 Budget.

Lastly, I want to offer my appreciation to your audit staff for their thoughtfulness and professionalism while conducting this audit.

Very truly yours,

Jeffrey J. Mantes
Commissioner of Public Works

Attachment

Frank P. Zeidler Municipal Building, 841 N. Broadway, Milwaukee, Wisconsin 53202
Administration, Room 501 (414) 286-8333 ♦ Fax (414) 286-3953 ♦ TDD (414) 286-2025
Contract Administration, Room 506 (414) 286-3314 Fax (414) 286-8110 ♦ www.mpw.net

Recommendation 1: Improve accuracy of Fleet inventory values

DPW Response: Fleet recognizes the importance of accurate inventory records and has always strived to maintain accurate records. We agree that Fleet's practice of tracking O&M funded consumable items in inventory at zero cost should be changed to include the actual cost, and we are complying with this recommendation. DPW will develop more specific definitions of what equipment and materials will be treated as inventory and will ensure that they are purchased with inventory funds and held in inventory at an accurate moving average cost.

Recommendation 2: Eliminate all "off-the-books" inventory

DPW Response: It is not Fleet's policy to allow off-the-books inventory. Instances of such found during the audit are mainly the result of two causes: Individuals attempting to simplify their jobs by ordering more parts then presently needed; Parts mistakenly ordered for the same vehicle at separate repair locations, due to a change in equipment location or other factors.

Both causes are related to management and staff reductions that have occurred over the past decade that have reduced oversight and slowed stores services. In 2010, a new Equipment Inventory Manager was appointed to Fleet. Since his appointment, he recognized and has worked to correct the issue of "off-the-books" inventory. Moving forward Fleet will:

- Identify and eliminate (install, return, remove as obsolete, or record as inventory) current "off-the-books" inventory.
- Appropriately address the causes of this issue, so that direct install parts are purchased only in quantities sufficient to meet the current need.
- Ensure that direct install parts not immediately installed will be received into inventory or returned for credit.

Recommendation 3: Redesign inventory reconciliation process

DPW Response: Fleet Services utilizes Fleet Focus, a computerized fleet maintenance information system, to track all of its equipment's repairs, maintenance costs, maintenance schedules, fuel use and related parts and supplies inventory. This functionality is highly advantageous for both fleet equipment management, as well as fleet parts inventory management. Unfortunately, due to the incompatibility of the Fleet Focus inventory system and the City's Peoplesoft financial system, reconciliation of inventory values between the two systems presents challenges due to the high transaction volume, transaction posting timing differences, and the manual nature of the process. We agree that this process can and should be improved. In working towards that goal, we will pursue the Audit recommendations. As to the recommendation that a year-end reconciliation be performed once voucher and journal entry is finalized, this has been performed since 2002 under

the guidance of the Comptroller's General Accounting Division.

Appendix A Enhancing the Reconciliation Process

RECOMMENDATION A1: All activity that affects the inventory balance should be first reported in the Fleet inventory system and than a process should be established as to how the activity will get reported in the FMIS general ledger system (i.e. through an IRI or other journal entry).
DPW Response: A longstanding IRI process that reports Fleet inventory activity to FMIS General Ledger already exists. However, we acknowledge that some Fleet inventory adjustment data was not reported, it was assumed to have been included in what was being reported to the FMIS General Ledger. Fleet will take steps to correct this gap in the process.

RECOMMENDATION A2: Given timing delays of activity hitting the FMIS general ledger, DPW should re-evaluate how it monitors the Fleet inventory balance to ensure the inventory system is accurate versus simply comparing the inventory system to the general ledger system. If the FMIS general ledger system is not current, the reconciliation cannot timely identify inaccuracies for investigation and correction by management.
DPW Response: Fleet has always worked to ensure that the Fleet Focus inventory module accurately reflects Fleet inventory activity. Due to data posting timing issues, the Fleet Focus inventory and FMIS General Ledger inventory are not likely to agree at any given point in time. Fleet will pursue audit recommendations to reduce data posting differences between the two systems and increase its ability to quantify any imbalance that might exist.

RECOMMENDATION A3: DPW management should establish reporting requirements to assist in proper cut-off of information being entered into the Fleet inventory system. Examples may include cut-off guidelines for entering receipts and adjustments into the Fleet inventory system sub-ledger at the end of each month, specific reporting requirements over receipt activity, and guidance over the timing of when inventory value reports are to be generated each month.
DPW Response: Fleet currently uses a fiscal period (monthly) cut-off point for all transaction entry including receipts and adjustments. Fleet will explore changing the timing of when reconciliation related reports are generated to better match the end of the fiscal period to be reviewed. This may not be possible due to staff workflow and workload considerations. As an alternative, Fleet will consider automating this reporting and examine ways to ensure the data being reported is only from the period under review, either by excluding or filtering out data from future fiscal periods.

RECOMMENDATION A4: DPW should continue to perform an annual comparison of the FMIS general ledger system to the Fleet inventory system at the end of each fiscal year and after all activity has been processed to the general ledger. Once the Fleet Focus inventory system has been determined to be accurate and complete, an adjusting entry should be posted to the FMIS general ledger system to bring the two systems in balance with each other.
DPW Response: DPW will continue to perform a year end reconciliation of the two systems as described in recommendation 3. We will pursue processing a year-end balancing adjustment prior to the closing of 2011 accounts.

RECOMMENDATION A5: Fleet should develop a process to batch its invoices in groups that match the receiving report generated out of the Fleet inventory system. Establishing a daily receipt log that ties to the batches of invoices, would allow management to identify those receipts or invoices which have not been processed for payment and therefore have not hit the general ledger.
DPW Response: This recommendation was recently attempted and was determined to be labor intensive and infeasible under current staffing resources. To implement such a process would require additional staffing of 0.25 FTE or authorizing staff overtime of approximately $10,000 annually.

RECOMMEDNATION A6: The DPW Inventory Manager should utilize the system generated reports and queries from Fleet staff when preparing the monthly reconciliation as it provides stronger support for the balances being analyzed.
DPW Response: While The DPW Inventory Manager does not himself run the queries used for the monthly reconciliation reports, he utilizes data that is generated from system reports and queries run by the Fleet Inventory Manager. Any transactions that appear odd are examined further using those reports and queries. Findings regarding the cause of imbalances are reported and tied to system detail. Also reported, is a brief description of each cause and a comment regarding follow-up action required. For any imbalance that can't be confirmed, the cause is listed as such. Copies of the monthly reports are provided to the Comptrollers General Accounting Division. It is our understanding that a Management Accounting Specialist from General Accounting reviews our report and validates the balances. On occasion they have called with questions, which we have addressed; and to our knowledge, to their satisfaction. DPW will explore the feasibility of requiring the Fleet Inventory Manager to send to all reports and queries used to generate monthly summary data in addition to, and at the same time, the monthly summary data is submitted to the DPW Inventory Manager.

Recommendation 4: Expand purchasing guidance in DPW policy

DPW Response: DPW recognizes the importance of good material controls and will review its Inventory Management Policy in the interest of controlling all parts and items.

Appendix B - Lack of Policy and Procedures for Special Order Purchases

RECOMMENDATION B1: Fleet needs to review the current process for acquiring special order commodity parts and implement internal controls over purchasing, receiving, tracking, and disbursing of the parts. Regardless of whether the part is installed on a piece of equipment or stored in the stockroom, there needs to be good control of the part from the time it is ordered to the time it is installed on the equipment.

DPW Response: Fleet recognizes the need for appropriate material controls and as such has long standing policies and procedures in place. To obtain new special order materials, an authorization request (signed by a repair supervisor) must first be submitted. There is then a paper and electronic documentation of the request, purchase, and receipt. Upon receipt of an invoice, appropriate payment approval is obtained before the invoice is forwarded to our Administration Services Division for voucher processing. Due to a two-year vacancy of an office assistant position and the high volume of transactions, some weakness in this process occurred. However, in 2010, the office assistant position was filled and the issues related to the vacancy are subsiding. Fleet is reviewing it's before and after-acquisition procedures, to avoid possible duplicate ordering and to ensure proper control and documentation of parts ordered but not installed.

RECOMMENDATION B2: Fleet should utilize its inventory system for tracking the purchase, receipt, and direct issue of the special order part because the system lowers the risk of the transaction being processed without sufficient documentation or support. The audit reviewed Fleet's inventory system manual and noted that the system has the capability to place special order purchases in the quick order screen and make a direct issue to the work order. Utilizing the inventory system to process significant special order purchases would minimize the risk of transactions being undocumented or unsupported.

DPW Response: Fleet is in the process of reviewing and testing the Fleet software application in regards to this recommendation. If this review and testing proves this system feature to be practical and reliable, Fleet will implement its use.

RECOMMENDATION B3: All significant commodity part purchases not directly installed on an equipment or vehicle need to be recorded into the inventory system so that there is proper documentation and control over the item.

DPW Response: Fleet is reviewing after-acquisition procedures to ensure proper control and documentation of parts ordered but not installed. The goal is to identify items purchased for direct installation that don't actually get installed within a reasonable time frame. Items identified as such will either be returned to the vendor for credit or received into inventory at its purchase price.

Recommendation 5: Clarify DPW definition of inventory

DPW Response: DPW's Inventory Policy includes a definition of inventory that was re-written in 2006 to replace a temporary definition offered by the Comptroller's office in 1995. Both definitions rely on management judgments to determine what an inventory item is within certain guidelines. Due to the wide variety of materials we use and the varied needs of our various divisions; an all inclusive definition of what is inventory is difficult to define. Recognizing this difficulty, DPW will review its Inventory Policy with the intent to revise its inventory definition to include the Audit recommendation of clear and measureable criteria.

Recommendation 6: Formalize and document Fleet procedures

DPW Response: Due to Fleet's unique use of a non-FMIS inventory control system; we agree that Fleet Management should develop written procedures specific to their inventory operations and in compliance to the spirit of DPW's overall Inventory Management Policy. See Appendix C for additional DPW response.

Appendix C - Internal Controls for Accounting and Transaction Documentation

RECOMMENDATION C1: The inventory disbursement form could be enhanced by adding a sequential number to the form so that missing documents can be investigated to ensure that all inventory disbursement activity is completely recorded.
DPW Response: Currently, disbursement record identification is sequenced by the City vehicle asset number. However, DPW will include sequencing numbers on its inventory disbursement form to provide additional administrative control.

RECOMMENDATION C2: Fleet needs to develop a process for formally documenting inventory transfers and stock returns in accordance with DPW policy and procedures.
DPW Response: Inventory transfers and stock returns have always been recorded electronically, paper documentation of transfers has been fully implemented during this audit, and paper documentation of returns is being developed.

RECOMMENDATION C3: Fleet should evaluate the DPW standard inventory transaction report to determine if it meets the needs of its common inventory transactions.

DPW Response: Fleet Management has considered the use of DPW standard inventory transaction form and feels that implementation of the changes recommended in C1 and C2 will duplicate the functionality of DPWs standard transaction form while better serving the specific needs of Fleet Services.

RECOMMENDATION C4: Fleet should review the reporting parameters set up in its inventory system for receipt reporting to fix any inaccuracies of actual activity. Linking this report to batched invoices sent over for invoice processing would allow for greater monitoring of receipt activity by the DPW Inventory Manager.
DPW Response: Fleet management has fully addressed the receipt reporting parameters issue. Beginning in April 2011, Fleet is now capturing previously un-reported "Inventory Receipt Returns" activity, along with the value of these inventory receipts. As for invoice batching please see our response to A5.

RECOMMENDATION C5: In connection with Fleet's review of proper segregation of duties, Fleet should ensure that individuals who perform the purchasing function are separate from the receipt function. In addition, the individual performing the purchasing should not also authorize the invoice for payment. Ideally, a manager should perform all significant purchases for payment.
DPW Response: Fleet's repair managers by policy have always performed the approval for payment of all special order purchases. Inventory purchase approval used to be the responsibility of an inventory management assistant position, but upon the elimination of that position, this approval was delegated to a lead worker. Fleet has now implemented a change to that practice, and all inventory purchases are now approved by the Fleet Inventory Manager. In regards to other aspects of this recommendation, Fleet Management has determined that current staffing levels and fundamental elements of the work require the cross-training of inventory personnel to perform both purchasing and receipt functions.

Recommendation 7: Reduce overlapping job responsibilities

DPW Response: As recommended, Fleet will review job responsibilities for the risk of transaction error or theft. Fleet has already changed how inventory purchases are approved. This is now done by the Fleet Inventory Manager. Where practical and appropriate, within available staffing resources and cost to benefit considerations, we will consider changing other work assignments and/or system access, and/or provide for additional staff training or adequate oversight.

Recommendation 8: Enhance controls over manual adjustments

DPW Response: Fleet will review work assignments and system access and as practical and appropriate, within available staffing resources, limit who has system access to make adjustments. See Appendix E for additional DPW response

Appendix E - Enhance Controls over Manual Adjustments

RECOMMENDATION E1: Fleet should limit the number of individuals that have access to post manual adjustments to a small number of individuals and establish a level of approval required before adjustments can be made. For example, adjustments to inventory prices should be restricted to appropriate users and for a justifiable reason.
DPW Response: Manual adjustment entry is presently limited to only the Fleet Inventory Manager, two lead workers, and one back-up clerk. Fleet will evaluate the operational impacts and consider removing this access from the back-up clerk or others, if feasible. It should be noted that, all adjustments are reason coded and are reviewed by the Fleet Inventory Manager for appropriateness on a monthly basis.

RECOMMENDATION E2: Physical inventory adjustments should not be handled manually but should be processed through the inventory systems variance handling module.
DPW Response: All adjustment types manual or automatic are and have always been processed through the inventory application software's adjustment functionality.

RECOMMENDATION E3: Inventory quantity adjustments should not be added back at a zero cost. The adjustment should be to the quantity at the current moving average cost price.
DPW Response: We agree, and this past practice has been discontinued. Further, to address these occasional incidents, a process to reconcile between the Inventory and O&M accounts will be developed.

RECOMMENDATION E4: All adjustments, manual or automatic, need to get recorded in the FMIS general ledger system.
DPW Response: We agree and this will be done in the future; complete reporting of all adjustments has been fully implemented to support the accurate recording of this data.

RECOMMENDATION E5: The DPW Inventory Manager should review and analyze all manual inventory adjustments.
DPW Response: Please see our comments for recommendation D1 at the end of this Attachment

to Department Response.

Recommendation 9: Improve physical security

DPW Response: Physical security of Inventory is a high priority for DPW. Efforts to maintain and improve security are an ongoing aspect of our inventory operations. Bi-annually, we circulate a checklist to our warehouse management asking them to review their facilities for needed repairs and improvements. Reported repair needs are addressed as quickly as possible; requested improvements are reviewed and if deemed appropriate, action is taken to implement those improvements, as funding and required resources are available. Card Reader Access log reports are reviewed regularly and when anomalies are noted they're investigated and appropriate responsive action is taken. See Appendix F for further DPW response.

Appendix F - Physical Security Controls

RECOMMENDATION F1: Fleet should remove stockroom access to any individual that does not regularly require access to perform their job function.
DPW Response: It has been our policy to limit access to those that work in the stockroom or may need to respond to emergency or maintenance situations. Our stockroom access lists have been reviewed annually to keep them appropriate and up to date; however Fleet agrees to take a more conservative approach to this process in the future. To supplement restrictive access to our stockrooms Fleet management reviews access log reports weekly and any questionable access is challenged.

RECOMMENDATION F2: Temporary access (i.e. facilities maintenance and IT Support) can be granted, however, Fleet should develop a process for granting, monitoring, and removing the temporary access.
DPW Response: We will explore having the City Hall Operator remotely activate any access needed after-hours.

RECOMMENDATION F3: The satellite locations need to re-establish a process for documenting and monitoring the after-hour access that occurs. The process should be in accordance with the guidelines found within the DPW Inventory Management Policy.
DPW Response: Currently, after-hours access to the satellite location stockrooms is limited. Exceptions include maintenance and repair, restocking or cycle counting by stores staff and during snow-emergencies. After-hours access to the Tire Shop is monitored weekly by Fleet's Inventory Manager via a review of the card access log report. At Tower, access requires first using a key card to enter the repair shop and then a key to enter the parts cage. At Lincoln and Northwest, access requires first using a key card to access the supervisor's office and then a key

to enter the stockroom. The card access log reports for these areas are monitored, but there's no reliable way to confirm parts cage or stockroom access. To better address security of these areas, Fleet is exploring the feasibility of replacing key access with a card reader. Fleet is also re-evaluating who has keys and also the possibility of re-keying these locks if card readers do not appear feasible in the near future.

RECOMMENDATION F4: Fleet should consider installing the key card system to the satellite locations so that the after-hour access log could be monitored.
DPW Response: Fleet has taken steps to address this concern. Card access pads have been added at the Tire Shop and also on the supervisor's office at the Lincoln satellite location, which must first be entered to gain access to the stockroom door. Where practical and as funding resources become available, we will take additional steps to address this issue.

RECOMMENDATION F5: Keys should be issued sparingly. If the individual already has access to stock room via key card, Fleet should determine if a key is still necessary for the other doors.
DPW Response: We agree and will limit the number of individuals who have both keys and cards. Also see our response to F1 above.

RECOMMENDATION F6: Fleet should consider installing key cards on any remaining unmonitored points of entry.
DPW Response: We assume this refers to the Central stockroom. As such, we agree. Where practical and as funding resources become available, we will comply.

Recommendation 10: Re-evaluate Fleet inventory needs

DPW Response: DPW routinely evaluates its inventory needs and will continue to do so in the future. Recently, we worked with the Budget Office on a study of our Infrastructure Inventory Operations. In regards to how Fleet purchases its materials; Fleet already buys a majority via a "just in time" approach. As the audit pointed out, approximately 52% of Fleet's 2010 purchases ($1,945,000 of $3,735,000) were direct purchases. The majority of its supply purchases are through vendor contracts established via a competitive bidding process. While Procard does have its benefits, and Fleet takes advantage when it's deemed appropriate, it isn't always an option. When it is, it doesn't always result in the lowest possible pricing. While it may be possible to increase the amount of direct purchases; a need for inventory will likely always exist due to the logistical advantages it provides, such as carrying additional stock into the winter season as it is

hard to find additional stock during periods of high demand.

Recommendation 11: Develop new monitoring tools and reports

DPW Response: DPW is open to suggestions to improve its operational and administrative oversight and will explore the implementation of the suggested bulleted items under this recommendation. Based on our thorough understanding of our operations and what's required to monitor them, we have employed a variety of tools and existing reports that address this recommendation's bulleted issues. Over time, we have added new reports and tools, and we've made modifications as they've been deemed appropriate. On the subject of modifications, DPW has requested capital funding in its 2012 Capital budget Request to examine the possibility of relocating its Streets and Electrical Services inventory stockroom at Canal Street to its inventory facility at 35th and Canal.

Appendix D - Cycle Count and Variance Handling

RECOMMENDATION D1: All physical count variances identified through the year during cycle count or other times should be documented and reviewed by the Inventory Manager. A quantity and dollar threshold should be established to give guidance over when a variance is investigated further.

DPW Response: Since January of 2007, DPW has taken a proactive approach to cycle counting. At that time, our inventory policy was revised to address a variety of documentation, procedural and review issues. This policy requires the Inventory Manager to review all cycle counts for count accuracy and to ensure each count is properly documented and conforms to department policy. It requires that a summary report of each count be issued and forwarded to divisional managers with oversight responsibilities. In addition, it requires a monthly cycle count summary report be issued and distributed that lists count progress and overall report variance to date, including dollar, unit and item accuracy data. Further, on a quarterly basis this information is presented to the Commissioner. At the end of each year, a variance report is produced that compares the year-endings counting activity against the prior 6 years. This allows us to identify patterns or trends. The report also breaks down counting results into various categories and the results are compared against established department guidelines; this will continue.

Just prior to the start of this Audit, we became aware that Fleet's manual count adjustments were not being included in this reporting and efforts were underway to correct this problem. Beginning with the start of 2011, Fleet's manual adjustments are now included.

While our inventory policy doesn't list a specific dollar variance investigation guideline, an implied guideline of +/- $1,000.00 has been in place for years. Variances over this threshold have

been reported in detail to divisional management as part of the Inventory Manager's monthly Cycle Count Summary report. We'll take under consideration whether or not this guideline needs to become more formal and also if a guideline for quantity variance would be useful.

RECOMMENDATION D2: All variances and adjustments should be recorded in a separate variance account in the general ledger.
DPW Response: This is currently done at all of our other warehouses and is a requirement of our inventory policy. At Fleet, all adjustment activity is coded in the Fleet Focus system, so the value of this activity can be extrapolated. In the future, when reported to FMIS via an IRI, program code 0922 (Physical Inventory) will be used to segregate it from other Fleet Transaction activity charges.

RECOMMENDATION D3: Inventory management should develop the counting schedule to ensure that all parts are scheduled to be counted once a year.
DPW Response: Fleet has a counting schedule that strives to complete all required counts within the months of February through November. However, workload, weather conditions and staffing resources can all impact the feasibility of taking a count and can also impact the quality of a count. For these reasons, our inventory policy allows counting schedules to be determined by the Warehouse Manager, as they are in the best position to determine when counting can be conducted in a manner that produces accurate results, is consistent with efficient warehouse operation, and when it will limit, as much as possible, the disruption of other daily warehouse activities.

RECOMMENDATION D4: Results from the cycle count should be entered blindly into the inventory system so that all variances can be system calculated. It is inefficient and weakens the control to manually check the inventory counts before entering the counts in the system.
DPW Response: Our inventory policy requires blind counts, and we will continue to enforce that requirement. It is our understanding that the auditors came across a situation where an individual was checking counts before entering them into the system. Fleet management talked to this individual, and his response was that he was not looking up every inventory item to compare results. Instead, he was spot-checking selected items which he suspected were normally kept at a greater stock level than what was counted, and where there was the possibility of additional stock in an overflow bin location that could have been missed. His action was in the spirit of ensuring an accurate count. Fleet has since taken steps to ensure overflow locations are picked up and, as such, spot checking for this won't be necessary. This individual has been instructed to discontinue this practice.

RECOMMENDATION D5: A separate individual should be responsible for posting the results of the count as well as posting any adjustments to inventory. The individual who counts the inventory should not be responsible for posting the results.

DPW Response: At Fleet, cycle counting is performed by a two-person team. Person 1 states the part number and quantity of the item on the shelf; person 2 records the quantity on the count sheet. Afterward, Person 2 enters the counts recorded on the count sheet into the Fleet Focus system. In the Fleet Focus software application, the posting and adjustment of the counts is one process and cannot be separated. Our recently acquired Office Assistant is being trained to perform the entry of the counts when scheduling allows. This, of course, takes the office assistant away from their primary duties (please reference recommendation B1). Fleet staffing is very tight, and in order to keep work moving forward, we may have no other option but to allow the same individual to do multiple counting tasks. It needs to be noted that Fleet's Inventory Manager reviews and then signs all posted counts. A report of his review findings is provided to key divisional management.

RECOMMENDATION D6: A separate analysis of the satellite locations should be performed over whether periodic cycle counts versus a full physical is more appropriate. There is less monitoring of inventory transactions at the satellite locations and therefore, it may make more sense to perform a full physical count each year to get the inventory balances accurate at least once a year.

DPW Response: It is our policy to count all inventory items at least once a year. At Fleet this happens in ten cycle segments. This is done to enhance count accuracy and limit disruption of normal work activities. A full physical count (or wall to wall count) would require additional man hours to complete and would likely have to be done on an overtime basis to avoid disrupting normal work activity. Industry best practices often cite full physical wall to wall counts as being less accurate. We question the benefit of a more costly, and potentially less accurate, full physical count.

DPW Summary Response: Of the Audit's 42 recommendations listed above, 31 we agree with and have complied, 9 are under review to determine if compliance is feasible and/or practical, one is not feasible due to staffing limitations and with one we disagree. To ensure our efforts to comply with these recommendations are successful and remain consistent, the availability of staffing resources is critical. We estimate that this assurance requires the addition of 1 Equipment Inventory Supervisor(Pay Grade 2) and 1 Office Assistant II(Pay Range 410) to current Fleet Stockroom staffing levels.