

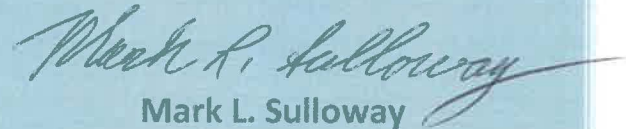
Audit #19-01:

# Fiscal Year End 2018 City-wide Inventory

## Audit Report

Office of the City Auditor and Clerk  
Internal Audit

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## Executive Summary

### Audit #19-01 Fiscal Year End 2018 City-wide Inventory

#### Audit Purpose and Scope

This audit was performed to assess the FYE 2018 physical inventory process, including compliance with inventory instructions and related controls over inventory. This audit was included on the 2017-2018 Audit Schedule.

The scope of this audit included a review of departmental inventory activities, including physical inventory counts, compliance with inventory policies and procedures, and physical and information system security regarding City assets for the fiscal year ending September 30, 2018. The time period for the audit was October 1, 2017 - September 30, 2018.

#### Report Content and Limitation of Use

This executive summary is limited in detail. To obtain the full background on a particular item, please review the details prior to drawing conclusions based upon the limited information contained in this summary.

#### Audit Conclusions & Objective Ratings

The results of our review are based upon current conditions and indicate that internal controls are generally in place and functioning effectively to ensure compliance with City policies and procedures; no significant exceptions were identified; exceptions are noted in the detailed observations and recommendations on pages 8-11 of this report.

For information on priority levels assigned to audit recommendations, please see [Exhibit A](#).

See the table on the following page for ratings of the seven audit objectives by individual department:



Bobby Jones Golf Course Pro Shop Merchandise

Audit Objectives	Objective Ratings						
Determine whether:	Bobby Jones Golf Club Pro Shop	Public Works Fuel Operations	Utilities Stores	Sarasota Police Department	Municipal Auditorium & Payne Park	Robert L. Taylor Community Complex	Van Wezel Performing Arts Hall
1. Departmental inventory procedures are adhered to during counts of inventory;	X	X	X	X	X	X	X
2. Physical access to inventory is appropriately restricted to safeguard City assets;	X	X	X	X	X	X	X
3. Access to inventory information systems is appropriately restricted to necessary personnel;	X	X	X	X	X	X	X
4. Reported inventory includes usable or saleable items;	X	X	X	X	X	X	X
5. Inventory cut-off procedures are adequate to ensure that inventory transactions are reported in the correct fiscal year;	X	X	X	X	X	X	X
6. Inventory amounts are properly recorded; and	X	X	X	X	X	X	X
7. Management oversight of the physical inventory count and reconciliation process is adequate to ensure adjustments are properly reviewed and authorized.	X	X	X	X	X	X	X

Objective ratings indicate the levels at which the objectives were met

Green – A green control rating indicated that the controls reviewed at the time of the audit indicated a satisfactory or acceptable state of control, where risk appears to be minimized and appropriately managed.

Yellow – A yellow control rating denotes opportunities for improvement exist relating to the controls reviewed.

Red – A red control rating denotes significant risk or exposure to the City that requires immediate attention and remediation effort.

## Detailed Report

### Audit #19-01 Fiscal Year End 2018 City-wide Inventory

#### Background and Introduction

During fiscal year 2018 (FYE 2018), four City departments or divisions maintained dollar value inventories greater than \$20,000: Bobby Jones Golf Club, Public Works-Fuel Operations, Utilities, and the Sarasota Police Department. Three departments maintained dollar value inventories less than \$5,000: Municipal Auditorium with Payne Park, Robert L. Taylor Community Complex, and the Van Wezel Performing Arts Hall.

A variety of items are held in inventory, some of which are used to service internal customers (such as infrastructure parts, fuel, police uniforms and supplies, etc.), whereas other items are held for resale to the public (such as sporting equipment, souvenirs, and concession food and beverages).

At the end of each fiscal year, departments that maintain inventory assemble count teams to perform physical counts of inventory items. Results of the counts are used to update inventory quantities in departmental inventory computer systems and adjust each department's inventory valuation. Adjustments to inventory valuations are provided to the Financial Administration Department for inclusion in the general ledger.

The following table summarizes inventory information by Department or Division:

Department or Location	Inventory Costing Method In Use (Exhibit B)	Inventory Count Method	Automated Inventory System In Use?	Ending Inventory Balance as of 9/30/18	Percent of 2016 Inventory Balance
Bobby Jones Golf Club Pro Shop	Weighted Average	Perpetual	Yes	\$55,354.80	7.448%
Public Works-Fuel Operations	Last Invoice <sup>1</sup>	Perpetual	Yes	\$64,339.01	8.657%
Utilities - Utilities Stores	First-In-First-Out (FIFO)	Perpetual	Yes	\$594,807.64	80.034%
Sarasota Police Department	First-In-First-Out (FIFO)	Perpetual	Yes	\$23,541.94	3.168%
Municipal Auditorium and Payne Park	Last Invoice <sup>1</sup>	Periodic	No	\$419.85	0.056%
Robert L. Taylor Community Complex	Last Invoice <sup>1</sup>	Periodic	No	\$3,289.21	0.443%
Van Wezel Performing Arts Hall	First-In-First-Out (FIFO)	Periodic	No	\$1,441.58	0.194%
<b>Grand Total Inventory Valuation/ Percent Tested by Internal Audit</b>				\$743,194.03	100%

<sup>1</sup> The use of last invoice costing is a non-standard costing method.

Public Works, in April 2014, sold their non-obsolete inventory to an outside vendor, NAPA, who in return contracted with the department to provide an integrated parts room in the Public Works shop. NAPA orders, receives, issues, maintains and controls all inventory for the Public Works department excluding Fuel Operations. Inventory that is issued to Public Works is reviewed and reconciled by management to the corresponding supporting documentation. This system was continued for fiscal years 2016-2018.

## Audit Purpose and Scope

This audit was performed to assess the FYE 2018 physical inventory process, including compliance with inventory instructions and related controls over inventory. This audit was included on the 2017-2018 Audit Schedule.

The scope of this audit included a review of departmental inventory activities, including physical inventory counts, compliance with inventory policies and procedures, and physical and information system security regarding City assets for the fiscal year ending September 30, 2018. The time period for the audit was October 1, 2017 - September 30, 2018.

## Audit Objectives

The audit focused on the following objectives:

- 1) Departmental inventory procedures were adhered to during counts of inventory;
- 2) Physical access to inventory was appropriately restricted to safeguard City assets;
- 3) Access to inventory information systems was appropriately restricted to necessary personnel;
- 4) Reported inventory included usable or saleable items;
- 5) Inventory cut-off procedures were adequate to ensure the inventory transactions are reported in the correct fiscal year;
- 6) Inventory amounts were properly recorded;
- 7) Management oversight of the physical inventory count and reconciliation process was adequate to ensure adjustments were properly reviewed and authorized.

## Audit Standards

The auditors conducted this audit in conformance with the International Standards for the Professional Practice of Internal Auditing and Generally Accepted Government Auditing Standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for findings and conclusions based on the audit objectives.

## Testing Methodology

To fulfill the audit objectives, Internal Audit:

- Interviewed appropriate personnel;
- Observed physical inventory counts of departments;
- Evaluated compliance with departmental inventory instructions;
- Performed sample test counts<sup>2</sup> and verified unit costs to assure accuracy and existence of items;
- Reviewed user access to inventory information systems;
- Evaluated segregation of duties concerning inventory activities;
- Reviewed inventory reconciliations and adjusting journal entries;
- Evaluated management's oversight of the physical inventory reporting process; and
- Reviewed the inventory systems for adequate controls and safeguards.

## Audit Criteria

Conditions observed during audit fieldwork were evaluated against the following sources:

- Departmental Inventory Instructions; and
- The United States General Accounting Office's Executive Guide on "Best Practices in Achieving Consistent, Accurate Physical Counts of Inventory and Related Property", dated March 2002.



SPD Equipment Storage

<sup>2</sup> A judgmental sample of inventory items was selected for audit testing based on either number of items in stock or price per unit.



## Audit Observations and Recommendations

Observations and recommendations in this report are offered as independent guidance to management for their consideration in strengthening controls. A complete list of Internal Audit's observations and recommendations begins on page 10 of this report. For information on priority levels assigned to audit recommendations, please see [Exhibit A](#).

- 1) Physical inventory counts were generally performed in compliance with each department's respective inventory instructions. Counts were conducted by two-person teams (counter and scribe) and were generally counted in the recommended sequence (left to right, top to bottom). Further, all departments appropriately utilized a blind count<sup>4</sup> method, which encourages the most accurate and reliable count. There was one exception to this observation: Fuel Operations - Inventory on hand is provided by an automated fuel monitoring system (Veeder-Root) installed directly in the fuel tanks. The Equipment Maintenance Coordinator prints a fuel inventory report measuring fuel in the underground tanks.



Public Works Fuel Veeder-Root Fuel Monitor

- 2) Adequate physical access controls were observed to be in place for the departments with regards to secure, lockable storage areas. There was one exception to this observation: Utilities maintains a few larger inventory items stored in an outside area within the fenced Utilities Department grounds. Access is available to all department employees with limited monitoring by storeroom staff. Staff indicated that items have in the past been removed without notice to storeroom staff. Staff further indicated that an enlarged inventory storage area is currently being developed to enclose the entire inventory.
- 3) Inventory information systems were restricted to necessary users.
- 4) Reported inventory values appropriately included usable, or saleable, items. The auditor observed that departments properly identified obsolete items and segregated those items from other inventory.
- 5) Departments were in compliance with inventory cut-off procedures.

<sup>4</sup> In a blind count, counters are provided part number(s)/ SKUs, description, location, and other information needed to perform the count, but they are not privy to the number of items recorded in the inventory system. This method reduces the risk of counters relying on a number they see on the inventory report and, instead, requires counters to physically perform the count and record the totals observed.

- 6) Generally, inventory amounts were properly recorded at each department. At the Utilities Department, sample testing of invoices to inventory valuation listings identified cost discrepancies. Of ten items tested, six had overstated inventory costs when compared to invoice costs. Based on current inventory levels of each of the tested items, there was a total overstated value of \$577.42 to the inventory. Staff advised that four of the price variations were caused by multiple purchases of the same item over time at different costs; one using FIFO instead of (department standard) cost averaging for pricing; and for one item they had no explanation as to the pricing difference. Staff corrected the identified pricing discrepancies during the audit.
- 7) Management was appropriately present at several of the physical counts and audit adjustments were approved by the department heads prior to submission to the Financial Administration Department. During internal audit procedures designed to agree departmental inventory totals to Finance's adjusted inventory at year-end, it was noted that the adjusting entry provided by the departments to Finance was recorded accurately.

## Recommendations Identified:

1. Utilities inventory is not completely contained within a restricted access area.
2. Utilities inventory sampling disclosed cost variations due to pricing error, timing of multiple purchases of inventory items, and FIFO instead of cost averaging being used.

Each observation and corresponding recommendation is further addressed on pages 10-11.



Utilities Primary Equipment Storage



Utilities Outside Inventory Items

**Observation #1 FYE 2018 City-wide Inventory**

Criteria	Condition	Priority	Cause	Effect
All inventory items should be secured to prevent their unauthorized removal.	A number of Utilities inventory items are not secured. All Utilities Department employees have unfettered access to these items.	Medium	The current Utilities inventory storage area is not large enough to contain all inventory items.	Inventory items might be taken without authorization. Inventory tracking of any removed items would be impossible.

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Audit Recommendation	Concur	Management Response	Due Date
Utilities inventory storage area expansion should be completed as soon as possible to allow for secure storage of all inventory items.	Yes	All the items contained within the Inventory Valuation report created on 09/30/18 are maintained within a secured area and are inventoried. The items out in the yard with accessibility to City Utility employees are items which have been directly purchased or issued to different departments. The Utilities Department recognizes the need to organize the area and maintain access control of the items within the yard. The material yard is scheduled to be reorganized to separate and stage items for each department. Supervisors within each division will be responsible for their items within the yard. Time of completion is June 30, 2019.	06/30/19

**Observation #2**

Criteria	Condition	Priority	Cause	Effect
Accurate inventory item pricing should be maintained.	<p>Inventory cost variations were identified between invoices and posted inventory item values.</p> <p>Staff corrected the identified pricing discrepancies during the audit.</p>	Low	<p>Pricing error was identified.</p> <p>Timing of multiple invoice purchase postings appeared to cause some of the differences.</p> <p>FIFO instead of Cost Averaging was at times being used.</p> <p>(Staff corrected the identified pricing discrepancies during the audit.)</p>	The inventory value may be misstated.

Audit Recommendation	Concur	Management Response	Due Date
Utilities Department should compare, as much as practicable, listed inventory values to invoices and make any adjustments or corrections necessary to confirm the actual inventory value.	Yes	It is evident that one item was keyed in wrong and the value associated with that item was impacted. The other discrepancies were due to the valuation report posting all the item's value based on their average cost. The system is set up under the First In First Out (FIFO) methodology however when the report is generated it is based on the average cost of the items. To address any errors in keying in the cost of items upon receipt the department will begin verifying the price within Cartegraph prior to processing the invoice within FMS. This will provide additional verification that the cost of items being stocked are correct within both systems.	01/31/19

## Exhibit A: Audit Priority Classification System

Internal Audit utilizes the following classification scheme applicable to internal audit recommendations and the appropriate corrective actions:

Priority Level <sup>1</sup>	Description	Implementation Action <sup>3</sup>
<b>High</b>	Fraud or serious violations are being committed or have the potential to occur, security issues, significant financial or non-financial losses are occurring or have the potential to occur. <sup>2</sup>	Immediate
<b>Medium</b>	A potential for incurring moderate financial or equivalent non-financial losses exists. <sup>2</sup>	Within 60 days
<b>Low</b>	A low priority observation indicates that the controls reviewed at the time of the audit indicated a satisfactory or acceptable state of control however operation or administrative process may be improved if certain additional changes are implemented.	60 days to 6 months

<sup>1</sup>The City Auditor and Clerk is responsible for assigning internal audit recommendation priority level categories. A recommendation that clearly fits the description for more than one priority level will be assigned the higher priority level.

<sup>2</sup> For an audit recommendation to be considered related to a significant financial loss, it will usually be necessary for an actual loss of \$25,000 or more to be involved, or for a potential loss (including unrealized revenue increases) of \$50,000 to be involved. Equivalent non-financial losses would include, but not be limited to, omission or commission of acts on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

<sup>3</sup> The implementation time frame indicated for each priority level is intended as a guideline for establishing target dates. Determining proposed action dates is the responsibility of the Charter Official(s) over the area(s) or function(s) audited.

*NOTE: Please note that this exhibit is a standard form which appears in every audit and is meant to be utilized to aid management in understanding the seriousness or potential seriousness of an audit observation. A "High" or "Medium" priority rating assigned to an audit observation should not be construed to mean that fraud or wrongdoing is, in fact, occurring but rather fraud or wrongdoing has the potential to occur in the absence of adequate internal controls.*

## EXHIBIT B: INVENTORY COSTING METHODS

**Last Invoice Cost** - All items in inventory are re-priced based on the last price paid. When this method is utilized, if prices have changed over time, the values used to price current inventory may not match the actual costs of the items.

**Weighted Average** - Inventory amounts are based on an average of the actual prices paid.

**First-In-First-Out (FIFO)** - Under this method, the cost of goods sold is based on the cost of the first items purchased and ending inventory amounts are based on the cost of the most recent items purchased (the last items in).

Generally Accepted Accounting Principles (GAAP) recognize three methods of recording inventory:

1. First-In, First-Out (FIFO)
2. Last-In, First-Out (LIFO)
3. Weighted Average

Inventory methods other than the above will require an adjustment to an approved method, if the amounts are material.