

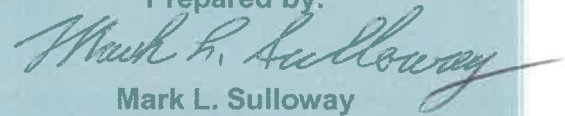
Audit #17-01:

# Fiscal Year-End 2016 Citywide Inventory

Detailed Audit Report

Office of the City Auditor and Clerk  
Internal Audit

Prepared by:

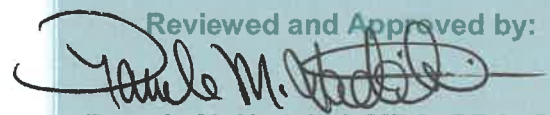


Mark L. Sulloway  
Senior Internal Auditor



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Manager Internal Audit

Reviewed and Approved by:



Pamela M. Nadalini, MBA, BBA, CMC  
City Auditor and Clerk /  
Chief Audit Executive

You can obtain copies of this report by contacting us at:

**Office of the City Auditor and Clerk**

1565 1<sup>st</sup> Street  
Sarasota, FL 34236  
(941) 954-4135

Or download and view an electronic copy by visiting:

[www.sarasotagov.com](http://www.sarasotagov.com)





**Date:** March 7, 2017

**To:** Mayor Willie Charles Shaw  
Vice Mayor Shelli Freeland Eddie  
Commissioner Liz Alpert  
Commissioner Suzanne Atwell  
Commissioner Susan Chapman

**From:** Pamela M. Nadalini, MBA, BBA, CMC, City Auditor and Clerk / Chief Audit Executive

**Subject:** Audit #17-01: Fiscal Year-End Citywide Inventory

Good afternoon, Mayor, Vice Mayor and Commissioners:

Attached for your information and review are copies of the detailed and executive summary audit reports.

If you have any questions, please do not hesitate to call me at (941) 954-4169.

Attachment(s):

Detailed Audit Report #17-01  
Executive Summary Audit Report #17-01

c: Thomas Barwin, City Manager  
Robert Fournier, City Attorney  
D. Edward Daugherty, CPA, Manager Internal Audit  
Mark Sulloway, Senior Internal Auditor  
File



**Date:** March 7, 2017  
**To:** Thomas Barwin, City Manager  
**From:** Pamela M. Nadalini, MBA, BBA, CMC, City Auditor and Clerk / Chief Audit Executive  
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Attachment(s):

Detailed Audit Report #17-01  
Executive Summary Audit Report #17-01

c: Marlon Brown, Deputy City Manager  
John Lege, Assistant City Manager  
Douglas Jeffcoat, Director, Public Works  
Mitt Tidwell, Director, Public Utilities  
Mary Bensel, Executive Director, Van Wezel Performing Arts Hall  
Chief Bernadette DiPino, Chief of Police, Sarasota Police Department  
Jerry Fogle, Director, Parks & Recreation  
Kelly Strickland, Director, Financial Administration  
Heather Essa, MPA, CIA, CGAP, CFE, CMC, Deputy City Auditor & Clerk  
D. Edward Daugherty, CPA, Manager Internal Audit  
Mark Sulloway, Senior Internal Auditor  
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## BACKGROUND AND INTRODUCTION

During fiscal year 2016 (FYE 2016), the following four City departments or divisions maintained high dollar value inventories: Bobby Jones Golf Club, Public Works-Fuel Operations, Utilities, the Sarasota Police Department; and three City departments maintained low dollar value (under \$1,000) inventories: Municipal Auditorium with Payne Park, Robert L. Taylor Community Complex, and the Van Wezel Performing Arts Hall.

During April 2014, Public Works 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 year 2016.

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 as well as to make adjustments to each department's inventory valuation. Adjustments to inventory valuations are provided to the Financial Administration Department for inclusion in the general ledger.



Bobby Jones Golf Club Pro Shop

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 9/30/16	Percent of 2016 Inventory Balance
Bobby Jones Golf Club	Weighted Average	Perpetual	Yes	\$56,229.90	12.44%
Public Works-Fuel Operations	Last Invoice <sup>2</sup>	Perpetual	Yes	\$49,341.59	10.92%
Utilities - Utilities Stores	First-In-First-Out (FIFO)	Perpetual	Yes	\$286,410.35	63.37%
Sarasota Police Department	Last Invoice <sup>2</sup>	Perpetual	No <sup>1</sup>	\$58,963.33	13.04%
Municipal Auditorium and Payne Park	Last Invoice <sup>2</sup>	Periodic	No	\$300.10	.07%
Robert L. Taylor Community Complex	Last Invoice <sup>2</sup>	Periodic	No	\$49.12	.01%
Van Wezel Performing Arts Hall	Last Invoice <sup>2</sup>	Periodic	No	\$697.08	.15%
<b>Grand Total Inventory Valuation/ Percent Tested by Internal Audit</b>				<b>\$451,991.47</b>	<b>100%</b>

## AUDIT PURPOSE

This audit was performed to assess the FYE 2016 physical inventory process, including compliance with inventory instructions and related controls over inventory. This audit was included on the 2015-2017 Audit Schedule.

## AUDIT SCOPE

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, 2016. The time period for the audit was October 1, 2015 - September 30, 2016.

<sup>1</sup> SPD does have inventory software; however, the software is not being utilized.

<sup>2</sup> The use of last invoice costing is a non-standard costing method.



Utilities Storage

## AUDIT OBJECTIVES

The audit focused on determining whether:

- 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

In order 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>3</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

## NOTEWORTHY ACCOMPLISHMENTS

SPD recorded a large write-down this year of \$49,396.87, to delete used or obsolete items that were maintained in inventory along with new stock. This should provide a more realistic balance of usable inventory on hand.

Public Works implemented all recommendations from the previous inventory audit (Audit 16-01).



SPD Equipment Storage

<sup>3</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 CONCLUSIONS

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 Administrative 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.
- 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.

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<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 actually observed.

- 6) Generally, inventory amounts were properly recorded.  
There were three exceptions to this observation:

SPD was not utilizing available inventory software to track inventory, receipt or dispersal of equipment during the fiscal year. This has been a recommendation in the past three audit reports.

SPD is not adding freight charges to the cost of inventory items. (Freight charges were noted in two of five items tested.)

In order to better control costs, Utilities Material Stores began an inventory consolidation program of the operational units within the Utilities Department including lift stations and the water plant during 2015. All inventory items from other units were transferred to Material Stores. As Utilities could not identify the original payee or the actual costs of the transferred items, they accounted for transferred items by booking them at zero cost, reducing the apparent average cost when added to purchased inventory on hand. Utilities departmental policy is to use these zero cost items first, and no charges are incurred by the operational unit when issued. The reduced inventory value will be cleared as the zero cost items are disbursed.

- 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.

## AUDIT OBSERVATIONS AND RECOMMENDATIONS

#	Subject	Priority	Observation	Recommendation	Concur	Do Not Concur	Management Response	Committed Action Item Due Date
1	SPD Inventory Software	Medium	Available inventory software (Crib Master or New World Systems) was not being used to track receipt and issuance of inventory items. This has been a recommendation in the past three audit reports.	<p>Implement the use of inventory software for all items in inventory, new purchases, and equipment issuance.</p> <p>Use of inventory software should provide up to date inventory stock levels and cost information and provide better tracking of stock items.</p>	Yes		Current implementation of CribMaster is taking place including items on hand, new purchases, equipment issuance, and item location. CribMaster has an acceptable costing system.	6/30/17
2	Utilities Zero Cost Items	Medium	Utilities consolidated inventory items received from other cost centers within Utilities into their inventory at zero cost as exact prices were not available. This artificially lowers the apparent cost of these items. This issue was a one-time occurrence as all inventory has been transferred to Utilities Materials Stores.	<p>Request cost information from the departments that provided inventory to Utilities (if available) and update item costs to more accurately reflect the cost of goods on hand.</p> <p>Exact cost-of-goods provides a more accurate inventory valuation.</p>	Yes		Utilities will obtain the cost for all of the inventory items received from other departments and update the software (Cartegraph) to reflect such prices in our inventory.	4/1/2017
3	SPD Freight Charges	Routine	Freight charges were not being added to item costs. Freight charges occurred with only certain vendors.	<p>Freight charges (when applicable) should be added to item cost to provide exact cost-of-goods information.</p> <p>Exact cost-of-goods provides a more accurate inventory valuation.</p>	Yes		This will occur with the implementation of CribMaster.	6/30/17

## 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>Routine</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.