

Audit #16-01:

# Fiscal Year-End 2015 Citywide Inventory

Detailed Audit Report

Office of the City Auditor and Clerk  
Internal Audit

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**OFFICE OF THE CITY AUDITOR AND CLERK**  
**Internal Audit Division**

**Date:** February 22, 2016

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

**From:** Pamela M. Nadalini, MBA, CMC, City Auditor and Clerk 

**Subject:** Audit #16-01: Fiscal Year-End 2015 Citywide Inventory

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Attached for your information and review is a copy of the above-mentioned detailed report.

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

**Attachments:**

Detailed Audit Report # 16-01  
Executive Summary Audit Report # 16-01

**Cc:** Thomas Barwin, City Manager  
Robert Fournier, City Attorney  
D. Edward Daugherty, CPA, Manager, Internal Audit  
File



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**C:** Robert Fournier, City Attorney  
Marlon Brown, Deputy City Manager  
John Lege, Director, Financial Administration  
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  
D. Edward Daugherty, CPA, Manager, Internal Audit  
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# TABLE OF CONTENTS

<b>BACKGROUND AND INTRODUCTION .....</b>	<b>5</b>
<b>AUDIT PURPOSE .....</b>	<b>6</b>
<b>AUDIT SCOPE .....</b>	<b>6</b>
<b>AUDIT OBJECTIVES .....</b>	<b>6</b>
<b>AUDIT STANDARDS .....</b>	<b>6</b>
<b>TESTING METHODOLOGY.....</b>	<b>7</b>
<b>AUDIT CRITERIA .....</b>	<b>7</b>
<b>NOTEWORTHY ACCOMPLISHMENTS.....</b>	<b>7</b>
<b>AUDIT CONCLUSIONS.....</b>	<b>7</b>
<b>AUDIT OBSERVATIONS AND RECOMMENDATIONS .....</b>	<b>10</b>
<b>EXHIBIT A: INTERNAL AUDIT RECOMMENDATION PRIORITIES.....</b>	<b>12</b>
<b>EXHIBIT B: INVENTORY COSTING METHODS USED BY CITY DEPARTMENTS..</b>	<b>13</b>

## BACKGROUND AND INTRODUCTION

During fiscal year 2015 (FYE 2015), the following city departments or divisions maintained inventory: Sarasota Police Department, Van Wezel Performing Arts Hall, Utilities, Public Works, Bobby Jones Golf Club, the Municipal Auditorium and Payne Park Auditorium. During April 2014 Public Works sold their non-obsolete inventory to an outside vendor, NAPA, who in return has contracted with the department to provide an integrated parts room in the Public Works shop. NAPA owns orders, receives, issues, maintains and controls all inventory for the Public Works department. Inventory that is issued to Public Works is reviewed and reconciled by management to the corresponding supporting documentation.

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).



Public Utilities storeroom is well organized, clean and well-lit.

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.

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 9/30/15	Percent of 2015 Inventory Balance Tested by Internal Audit
Municipal Auditorium and Payne Park Auditorium	Last Invoice <sup>1</sup>	Periodic	No	\$340.75	0.08%
Utilities-Utility Stores	First-In-First-Out (FIFO)	Perpetual	Yes	\$219,479.20	51.01%
Public Works-Fuel Inventory	Last Invoice	Perpetual	Yes	\$63,911.44	14.85%
Bobby Jones Golf Club Pro Shop	Weighted Average	Perpetual	Yes	\$35,724.11	8.30%
Van Wezel Performing Arts Hall	Last Invoice	Periodic	No	\$2,480.75	0.58%
Sarasota Police Department	Last Invoice	Perpetual	No <sup>2</sup>	\$108,360.20	25.18%
<b>Grand Total Inventory Valuation/ Percent Tested by Internal Audit</b>				<b>\$430,296.45</b>	<b>100%</b>

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

<sup>2</sup> SPD does have inventory software; however the software is not being utilized effectively.

## AUDIT PURPOSE

This audit was performed to assess the FYE 2015 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, 2015. The time period for the audit was October 1, 2014 - September 30, 2015.

## 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 that inventory transactions are reported in the correct fiscal year;
- 6) Inventory amounts were properly recorded; and
- 7) Management oversight of the physical inventory count and reconciliation process was adequate to ensure adjustments were properly reviewed and authorized.



Example – Public Utilities maintains a wide variety of parts including large, bulky items.

## AUDIT STANDARDS

The auditor conducted this audit in accordance with generally accepted government auditing standards. Those standards require that the auditor plan and perform the audit to provide a reasonable basis for findings and conclusions based on audit objectives. The auditor believes that the evidence obtained provides a reasonable basis for findings and conclusions based on the audit objectives.

The Internal Audit Division strives to follow the guidance included in the Institute of Internal Auditors (IIA) International Professional Practices Framework however the Standards do not allow the department to note

that reports are prepared in accordance with IIA Standards until the peer review process indicates such compliance.

## 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.



Example – Bobby Jones Pro Shop sells a variety of clothing and golf equipment for men and women.

## AUDIT CRITERIA

Conditions noted by Internal Audit during testing and fieldwork were compared to audit criteria, which included:

- 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

During testing of audit objectives for Bobby Jones Golf Course and Utilities it was noted that both departments have implemented and continue to maintain audit recommendations from the prior year inventory audit (#14-01) in addition to maintaining clean, organized and clearly marked inventory items. Both departments continue to spend time and resources on continuing to ensure their inventory practices are in line with their respective inventory policies as well as considering how internal controls strengthen their department's inventory operations.

## AUDIT CONCLUSIONS

Observations and recommendations in this report are offered as independent guidance to management for their consideration in strengthening controls.

<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.

A complete list of Internal Audit's observations and recommendations is located on page 10 of this report. For information on priority levels assigned to audit recommendations, please see [Exhibit A](#).

Based on results from testing the auditor's sample, Internal Audit determined through fieldwork and testing that:

- 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:
  - o **Fuel Operations** - does not have an inventory instruction procedures manual. Inventory on hand is provided by an automated fuel monitoring system (Veeder Root) installed directly in the fuel tanks. One central person prints a fuel inventory report measuring fuel in the underground tanks.
- 2) Adequate physical access controls were observed to be in place for the majority of the departments with regards to secure, lockable storage areas.



Example - Van Wezel sells a variety of items to patrons.

- 3) Inventory information systems were generally 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.

- 6) Generally, inventory amounts were properly recorded.

There were two exceptions to this observation:

- o **Sarasota Police Department-** Internal Audit noted that, after the 2015 physical inventory count, SPD appropriately submitted an updated inventory valuation to the Financial Administration Department to reflect the current inventory. While the inventory system has been in place for four years, it has not been fully implemented or utilized. No additions or issues were posted to the inventory system during the year. This results in inaccurate or incomplete data during the year and eliminates benefits inherent in a computerized inventory system. This also affects the item pricing, since there are no adjustments for higher or lower priced as items are added and issued. Additionally, the current inventory stockroom and listing includes new and used inventory items. Used items may have a reduced value from the original invoice price based on the Quartermaster's knowledge of the item. Without proper records and safeguards in place inventory becomes more susceptible to error, theft or manipulation. Additionally, inaccurate or

<sup>4</sup> In a blind count situation, 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.

incomplete inventory records can result in undetected theft and loss, overstocking items or not having items on hand at all which can cause difficulties in meeting the department's needs. Not maintaining the inventory system, CribMaster, increases the risk that inventory on-hand will be missed or taken out of inventory in error.

- **Sarasota Police Department** - The location code for items currently consists of the numbers 02 and the stock number of the item (Ex. – 02-5000280) rather than the actual location. Additionally, item descriptions currently do not provide an appropriate format for searching or reporting. The description should start with the item, followed by modifiers (Ex. – Shirt, Mens, Blue, Long Sleeve, 15 X 34) rather than the current format (Long Sleeve Blue Mens Police Shirts 15 X 34). These descriptions and item numbers should be included on the inventory item or on bin/shelf that hold the inventory item.
- 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 the departments to Finance was recorded accurately. There was one exception to this observation:
- **Fuel Operations** does not currently have a process in place that includes an active role for management in year-end fuel measurement and fuel adjustment approval.

# AUDIT OBSERVATIONS AND RECOMMENDATIONS

Issue #	Subject	Priority	Observation	Recommendation	Concur	Do not Concur	Management Response	Committed Action Item Due Date
1	Inventory Instructions Sarasota Police Department	High	<p>SPD has partially implemented new inventory software for the Quartermaster's facility. The software was purchased in 2011 and stock items have been entered and values assigned, however, purchases and issues have not been posted. Additionally costs have not been adjusted to comply with generally accepted accounting principles (GAAP). (We did note that new software has been purchased to maintain inventory, however it has not been implemented.)</p> <p>Quantities for stock items were adjusted based upon the year-end counts and an adjustment for the inventory value was provided to the Finance Department. However, since the inventory values are not maintained in accordance with GAAP it is likely that the inventory value was over- or understated.</p>	<p><b>Implement the inventory software by:</b></p> <ul style="list-style-type: none"> <li>• posting stock purchases and issues, utilizing an acceptable costing system (LIFO),</li> <li>• assigning locations for stock items, set reorder levels</li> <li>• identify slow-moving or obsolete stock</li> <li>• utilize reporting system for inventory worksheets</li> <li>• identify and separate used inventory from new inventory</li> <li>• determine if used inventory should have a zero value</li> </ul>			<ul style="list-style-type: none"> <li>• Inventory software (New World) implementation to be completed by 30May16.</li> <li>• Stock prices to be posted utilizing issuing invoices or comparative match from like vendor.</li> <li>• Locations to be posted to software program after completion of stockroom reset.</li> <li>• A default reorder level of 5 will be utilized unless movement supports other.</li> <li>• Identification of Slow moving and obsolete stock – Complete</li> <li>• Inventory reports will be generated from New World once implementation is complete.</li> <li>• Stockroom Reset to be implemented to support separation of new stock items from used recycled items. Only new stock items to be posted and tracked by New World system. This will allow for a true real-time cost analysis of the SPD stockroom. *Note 1, possible requirement for a one time financial adjustment on balance sheet for SPD once reset and implementation is complete.</li> </ul>	3/30/216

Issue #	Subject	Priority	Observation	Recommendation	Concur	Do not concur	Management Response	Committed Action Item Due Date
2	Fuel Operations Inventory Procedures Manual Public Works	Medium	There is not currently an inventory procedures manual that provides procedures for year-end inventory count.	We recommend that inventory procedures are documented, maintained and updated as is necessary.	X		Prepare standard operating procedure for monthly and annual inventory of fuel maintained for PW 12th Street Fuel Island.	2/29/2016
3	Fuel Operations Inventory Adjustment Review Public Works	High	Fuel Operations does not currently have a review of variances or adjustments to fuel by a supervisor.	We recommend that fuel inventory variances and adjustments be reconciled on a monthly basis and thoroughly reviewed and approved by management.	X		SOP will include review and approval by management	2/29/2016

## EXHIBIT A: INTERNAL AUDIT RECOMMENDATION PRIORITIES

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

- 1 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.
- 2 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.
- 3 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.