

Audit #15-01:

# Fiscal Year-End 2014 Citywide Inventory

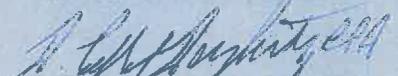
Detailed Audit Report

Office of the City Auditor and Clerk  
Internal Audit

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

**Date:** January 15, 2015

**To:** Mayor Willie Shaw, Vice Mayor Susan Chapman, Commissioner Suzanne Atwell, Commissioner Eileen Normile, and Commissioner Stan Zimmerman

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

**Subject:** Audit #15-01: Fiscal Year-End 2014 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 # 15-01  
Executive Summary Audit Report # 15-01

**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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## BACKGROUND AND INTRODUCTION

During fiscal year 2014 (FYE 2014), the following city departments or divisions maintained inventory: Sarasota Police Department, Van Wezel Performing Arts Hall, Public Works, Public Utilities, 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. The remaining obsolete inventory was written off at the end of FYE 2014. 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, 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 9/30/14	Percent of 2014 Inventory Balance Tested by Internal Audit
Municipal Auditorium and Payne Park Auditorium	Last Invoice <sup>1</sup>	Periodic	No	\$310.58	27.00%
Public Utilities-Utility Stores	First-In-First-Out (FIFO)	Perpetual	Yes	\$137,380.67	14.72%
Bobby Jones Golf Club Pro Shop	Weighted Average	Perpetual	Yes	\$31,807.28	15.71%
Van Wezel Performing Arts Hall	Last Invoice	Periodic	No	\$1,756.45	95.72%
Sarasota Police Department	Last Invoice	Perpetual	No <sup>2</sup>	\$112,798.42	7.73%
<b>Grand Total Inventory Valuation/ Percent Tested by Internal Audit</b>				<b>\$284,053.40</b>	<b>12.19%</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 2014 physical inventory process, including compliance with inventory instructions and related controls over inventory. This audit was included on the 2014-2016 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, 2014. The time period for the audit was October 1, 2013 - September 30, 2014.

## 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 audit recommendations from the prior year inventory audit (#14-01) in addition to maintaining clean, organized and clearly marked inventory items. Both departments 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.
  - o **Sarasota Police Department** - During the recount sample testing performed by Internal Audit, there were two inventory items (in the sample) that were not counted at all, a result of not following count procedures and not counting a section of shelves that contained inventory.
- 2) Adequate physical access controls were observed to be in place for the majority of the departments with regards to secure, lockable storage areas. There was one exception to this observation:
  - o **Sarasota Police Department** - 22 employees have key fob access to the SPD inventory storeroom. It does not appear that all of those employees have an active function in the inventory process or need to access the room.



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

3) Inventory information systems were generally restricted to necessary users. There was one exception to this observation:

**Sarasota Police Department** – Internal Audit noted that the prior Quartermaster still had user access rights to the inventory software (CribMaster). User access should be reviewed and updated on a timely basis for personnel changes within the department to prevent unauthorized changes.

- 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 2014 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 three 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. The Sarasota Police Department has a Physical Inventory Instructions Manual that includes procedures for Preparation for Taking Inventory, Taking Physical Inventory and Adjustments of Records. These procedures help to provide controls over the counting and maintaining of physical inventory to mitigate risk associated with the City's assets. Without proper records and safeguards in place inventory becomes more susceptible to error whether or not through manipulation, theft or

recording errors. Additionally, inaccurate or 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, during the year along with not having an organized and well labeled stockroom increases the risk that inventory on-hand will be missed or taken out of inventory in error.

- The Sarasota Police Department implemented a new inventory system three (3) years ago (CribMaster) for inventory items and fixed asset tracking. As noted in the prior year audit (Audit #14-01), the inventory implementation has not fully occurred. As of September 30, 2014 stock purchases had not been added and stock issues had not been deducted from inventory. This also affects the item pricing, since there are no adjustments for higher or lower priced as items are added and issued. Additionally, 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 directors 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 Public Utilities to Finance was recorded twice in error. The error resulted in Public Utilities' inventory at year-end being understated; the error was brought to the attention of Finance by Internal Audit and was appropriately corrected.

# 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	During the recount sample testing performed by Internal Audit, there were two inventory items (in the sample) that were not counted at all, a result of not following count procedures and missing a section of shelves to count that had inventory on them. Additionally there were four inventory items (in the audit sample) that were miscounted which resulted in incorrect inventory amounts being reported. These inventory item counts were subsequently corrected in SPD's inventory.	Departmental inventory instructions should be provided and reviewed by members of the count teams prior to the physical inventory. Having a department manager that is familiar with current inventory activities observing the physical counts can help to provide guidance and clarity for any count issues that may arise. Additionally, once the department begins to utilize the inventory software and updates physical counts real time a variance report should be printed to help identify errors made during the counts.	Concur	X	Keep a departmental inventory instruction manual in the Quartermaster's office at all times. The day prior to the inventory count, the Quartermaster will go over the manual and instructions with anyone assisting to brush up on inventory activities prior to conducting the physical counts. Utilize the department inventory computer software to prepare variance reports to identify errors and make the process efficient and accurate on a regular basis once the program is being utilized again to make inventory and audit process less cumbersome.	2/15/2015

Issue #	Subject	Priority	Observation	Recommendation	Concur	Do not Concur	Management Response	Committed Action Item Due Date
2	Inventory Software and Storeroom Sarasota Police Department	High	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).  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.	Implement the inventory software by: <ul style="list-style-type: none"> <li>posting stock purchases and issues,</li> <li>utilizing an acceptable costing system (LIFO),</li> <li>assigning locations for stock items,</li> <li>setting reorder levels</li> <li>identifying slow-moving or obsolete stock</li> <li>utilizing reporting system for inventory worksheets</li> </ul> Consider having the inventory storeroom staffed by someone to oversee, organize and maintain the inventory storeroom along with performing the functions listed above. A policy should also be implemented for releasing inventory items during unstaffed hours. (We did note that a posting for the Quartermaster position is currently open and a potential candidate has been identified.)	X		A Quartermaster for the Sarasota Police Department has been hired; targeted start date is January 7, 2015. This person has experience in military stockrooms. The current Cribmaster program is military based. The new Quartermaster can evaluate whether it is feasible to update and start utilizing the Cribmaster program or if the inventory program with New World (the agencies new Report Writing System) would be better. Once that decision is made, implement training on the software and begin utilizing the computer based program to track and order inventory. The SPD is no longer going to utilize their inventory room to keep large amounts of equipment/clothing etc. on hand. Only critical items will be stocked with identified levels of items to keep on hand. With current ease of online ordering, the majority of items can be ordered on an as needed basis.	7/31/2105
3	Inventory Stockroom Access Sarasota Police Department	High	During audit observation and testing it was noted that 22 individuals have been approved and currently have access to the inventory stockroom via each employee's key fob. Based on reports that detail which employees accessed the inventory stockroom with their key fob from October 1, 2013 - September 30, 2014, it was noted that four SPD civilian employees entered the stockroom approximately 395 times throughout the year between 5pm - 1am.	Stockroom access should be reviewed on a regular basis to determine that only individuals who truly need access to the stockroom have been approved. Although the inventory stockroom is locked, the inventory items are in the open in the stockroom. Individuals who are not responsible for inventory should not have access to unsecured inventory.		X	After 2013 Audit, four SPD cleaning crew members were taken off the list to have access to the Quartermaster's office. They were allowed to utilize the area to store their personal belongings while working, to include their paperwork, department cell phones charging stations, etc. Arrangements were made for these things to be stored in the common maintenance office. Quarterly, the SSD Commander should review the access list to the Quartermaster's Office.	12/16/2014

## 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>	Operation or administrative process will be improved.	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 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.