

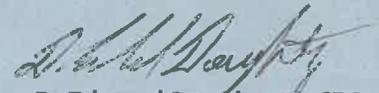
Audit #14-01:

# Fiscal Year-End 2013 Citywide Inventory

Detailed Audit Report

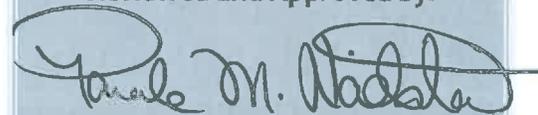
Office of the City Auditor and Clerk  
Internal Audit

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

**Date:** March 13, 2014

**To:** Mayor Shannon Snyder, Vice Mayor Willie Shaw, Commissioner Suzanne Atwell, Commissioner Paul Caragiulo, and Commissioner Susan Chapman

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

**Subject:** Audit #14-01: Fiscal Year-End 2013 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 # 14-01  
Executive Summary Audit Report # 14-01

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



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Detailed Audit Report # 14-01  
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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 2013, 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.

A variety of items are held in inventory, some of which are used to service internal customers (such as equipment maintenance, 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 (Appendix B)	Inventory Count Method	Automated Inventory System In Use?	Ending Inventory Balance as of 9/30/13	Percent of 2013 Inventory Balance Tested by Internal Audit
<b>Municipal Auditorium and Payne Park</b>	Last Invoice <sup>1</sup>	Periodic	No	\$489.33	31.07%
<b>Public Utilities-Utility Stores</b>	First-In-First-Out (FIFO)	Perpetual	Yes	\$74,594.39	9.43%
<b>Public Works-12<sup>th</sup> Street Equipment Maintenance and Fuel/Oil</b>	First-In-First-Out (FIFO)	Perpetual	Yes	\$157,119.46	5.35%
<b>Bobby Jones Golf Club Pro Shop</b>	Weighted Average	Perpetual	Yes	\$40,943.58	15.66%
<b>Van Wezel Performing Arts Hall</b>	Last Invoice	Periodic	No	\$876.84	65.98%
<b>Sarasota Police Department</b>	Last Invoice	Perpetual	Yes	\$116,535.38	3.94%
<b>Grand Total Inventory Valuation/ Percent Tested by Internal Audit</b>				<b>\$390,558.98</b>	<b>7.89%</b>

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

## AUDIT PURPOSE

This audit was performed to assess the FYE 2013 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, 2013. The time period for the audit was October 1, 2012 - September 30, 2013.

## 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;
- 7) Management oversight of the physical inventory count and reconciliation process was adequate to ensure adjustments were properly reviewed and authorized; and,
- 8) Inventory systems were operating as designed, with adequate controls and safeguards.



Public Works maintains a wide variety of parts, including large, bulky items, such as brake parts for heavy equipment

## 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 and adhere to the guidance included in the International Professional Practices Framework set forth by the Institute of Internal Auditors.

## 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>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.



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

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<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 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 is located on page 11 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 counted in the recommended sequence (left to right, top to bottom). Further, all departments appropriately utilized a blind count<sup>3</sup> method, which encourages the most accurate and reliable count.
- 2) Adequate physical access controls were observed to be in place for the majority of the departments with regards to secure, lockable storage areas.



Van Wezel Performing Arts Hall sells a variety of items to patrons.

With regards to segregation of duties concerns, the prior audit noted opportunities exist for all departments to realign job tasks to better reduce theft/ fraud risk as several employees were responsible for incompatible or excessive duties (i.e., in one instance an employee was able to order, receive, initiate payment, modify inventory records, perform counts, and reconcile/ adjust inventory valuations).

Internal Audit met with each inventory department to discuss how an appropriate separation of inventory duties could be achieved specific to them; the departments have reallocated duties and put compensating controls in place for duties that could not be reallocated. There are departments that will continue to have issues with segregation of duties because of limits on staff.

- 3) Inventory information systems were better restricted to necessary users when compared with the most recent inventory audit (Audit #12-01); however there continue to be concerns specifically regarding the Cartegraph system where there are users with capabilities to modify records, considering job responsibilities.

Further, for all departments to reduce the risk of loss, individuals responsible for maintaining inventory/ stock keeping should not be able to modify the inventory records; in the event this cannot be avoided, compensating controls should be put in place (such as periodic management review of modified records).

- 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.

<sup>3</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.

- 5) Departments were in compliance with inventory cut-off procedures.
- 6) Generally, inventory amounts were accurately reported to the Financial Administration Department.

There were two exceptions to this observation:

**Sarasota Police Department-** Internal Audit noted that, after the 2013 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 two years, it has not been fully implemented. 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.

**Utility Stores-** The original inventory value submitted to Financial Administration was unintentionally overstated by \$25,966.26. The auditor was able to determine, as a result of sample testing, that the report generated by the inventory system was not appropriately reporting the values for all items in the stockroom. Department staff was notified of the observation and staff was able to correct the issue. A corrected inventory value was immediately submitted to Financial Administration to reflect the decreased value after the reporting issues were remedied (inventory value was revised from \$25,725.09 to the correct amount of \$74,594.39). The issue was corrected prior to release of the audit report, so no recommendation is necessary at this time.



The Garage at the Public Works Department maintains inventory in a series of small rooms

7) Management was appropriately present at several of the physical counts; as recommended in the prior audit report, audit adjustments were approved by the department heads prior to submission to Finance.

- 8) Inventory systems were operating as designed with adequate controls and safeguards. There were three areas that could be improved:
  - a. The Sarasota Police Department implemented a new inventory system two (2) years ago (Crib Master) for inventory items and fixed asset tracking. The inventory implementation has not gone well. As of September 30, 2013 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. 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, Men’s, Blue, Long Sleeve, 15 X 34) rather than the current format (Long Sleeve Blue Men’s Police Shirts 15 X 34).
  - b. Bobby Jones Golf Complex uses the EZLinks software for course management and inventory. In discussing the software with the Account Manager for EZLinks, the auditor was told the software has no requirements as far as format (minimum length, upper or lower case, numbers or special characters). The current software also masks existing passwords with five asterisks (\*\*\*\*\*), regardless of the actual number of characters in the password.

- c. The Public Utilities storeroom was very well organized, with non-stock items (special orders and returns clearly marked and segregated). However auditors noted inconsistencies in several parts' stock numbers (the number recorded in Cartegraph was for the next item of stock (Ex. – UT 510448800802 should be Item # UT 51044800705, UT 5104400804 should be UT 5104400802). This could cause errors when ordering additional inventory.

# AUDIT OBSERVATIONS AND RECOMMENDATIONS

#	Subject	Observation	Recommendation	Management Response
1	Segregation of Duties & Inventory System User Rights-  <i>All Departments</i>	<p><b>All Departments:</b> Segregation of duties concerns exist for all departments with regards to various employees performing inventory tasks that are incompatible. Having excessive duties within the inventory control process is a fraud/ theft risk.</p> <p><b>Bobby Jones Golf Club, Public Utilities, Public Works, SPD:</b> The individual considered to be the “Custodian” of inventory was able to modify the perpetual inventory system and (in some cases) reconcile the inventory records, which is a fraud/ theft risk.</p> <p>Segregating duties in the inventory management process assists in better control over physical inventory through reduced risk of loss and misstatements in counts and value. If it is not practical to achieve the ideal segregation of duties due to limited resources/ staff, compensating controls should be implemented to reduce risk.</p>	<p><b>All Departments:</b>  <b>Separate inventory duties,</b> or implement compensating controls for duties, so that:</p> <ol style="list-style-type: none"> <li>1) The person who receives/ signs off on inventory is not involved in the purchasing process (particularly, cash disbursement),</li> <li>2) The person who has custody of the merchandise (Custodian) does not modify the inventory system or reconcile inventory counts to the inventory system/ general ledger,</li> <li>3) The person who modifies the inventory system (adds/ edits/ deletes items) does not reconcile inventory counts to the inventory system/ general ledger.</li> </ol> <p><i>(See Exhibit B for additional information on Segregation of Duties and Potential Compensating Controls.)</i></p> <p><b>Bobby Jones Golf Club, Public Utilities, Public Works, SPD:</b>  <b>Monitor access rights in departmental inventory systems</b> so that they are commensurate with job responsibilities and reflect an appropriate segregation of duties (i.e., Custodian should not be able to modify records).</p>	<p><b>Bobby Jones Golf Club:</b> 1) a) Currently being done for general merchandise. On occasion, pre-paid special orders are received by the manager in order to get product to customer.                      b &amp; c) Currently being done</p> <p>2) The EZ Links POS system software does not have the ability to segregate access rights within the "Inventory &amp; Sales Items" module. Assigned staff has either full access or no access. For example, the merchandise custodian must be able to monitor stock levels and sales. That data is found in the "Inventory &amp; Sales Items" module which in turn gives him full access to all inventory aspects (add/edit/delete items).</p> <p>Limited staffing levels, does not provided for complete separation of all duties, so to compensate, staff with access to inventory maintenance have been instructed not to make adjustments outside his/her assigned duties. The Golf Course Manager is the only person adjusting inventory after merchandise is received into the system. A report is generated when such an adjustment is made and the reason why documented. This report is reviewed by the Director.</p> <p>POS system provider was contacted last year about modifying access rights within this module for individual users. It's not possible now, but will be considered for future software updates. To date, no changes have been made.</p> <p><b>Public Works:</b> Currently negotiating an Agreement for Parts Room Integrated Management to handle all inventory responsibility. Agreement approved by City Commission on 02/18/14. Estimate 90 days Implementation.</p> <p><b>Public Utilities- Utility Stores:</b> 1. A. Currently individual who orders materials only checks in materials, invoice processing is handled by Accounting Specialist. B. All adjustments to inventory are performed by Public Works Finance and Administration Manager. C. Once Supervisor of Utility Stores is hired, additional segregation of duties will be put in place to address this issue.                      2. Work with IT Department to ensure segregation of duties.</p> <p>Management will advertise the current vacant position of Utility Stores Supervisor. Once individual is in place, additional segregation of duties will be enacted. This process will take approximately 180 days to hire and train and ensure all groundwork is set to enact the new procedures.</p>

				<p><b>SPD:</b></p> <ul style="list-style-type: none"> <li>• SPD will review the existing structure to ensure segregation of duties are maintained</li> <li>• SPD will review the existing structure to ensure segregation of duties is maintained. If Quartermaster has to receive inventory due to staffing: <ul style="list-style-type: none"> <li>a. the order form is sent to A/P</li> <li>b. Signed packing slip is sent to A/P</li> <li>c. Invoice is sent directly from vendor to A/P clerk</li> </ul> </li> <li>• Staff (other than the custodian) will receive orders, invoices will be processed for payment by the Fiscal Office</li> <li>• SPD is negotiating a contract to allow on-demand procurement of most items currently carried in inventory. This will result in a greatly reduced inventory. <ul style="list-style-type: none"> <li>a. Galls ordering process should be fully implemented by 4/30/14</li> </ul> </li> <li>• Modifications to inventory quantities will continue to be made by Fiscal Office staff. SPD will consult with the software provider to determine if system rights can be set to limit access to certain users. If not other compensating controls will be established.</li> </ul> <p><b>Van Wezel Performing Arts Hall:</b> We have a small staff but have spread the responsibilities around to the best of our ability, given our resources.</p> <ul style="list-style-type: none"> <li>• General Manager is the person who modifies the inventory system.</li> <li>• Volunteers sell the merchandise during the shows.</li> <li>• The Financial Assistant/Accountant or the Rental Agent will check in the merchandise.</li> <li>• 2 of the following positions will take the inventory counts: Financial Assistant/Accountant, Rental Agent or Administrative Assistant.</li> </ul>
2	<p>Inventory Software</p> <p>Sarasota Police Department</p>	<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).</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 Financial Administration Department. However, since the inventory values are not maintained in</p>	<p><b>Implement the inventory software by:</b></p> <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>	<p><b>SPD:</b></p> <ul style="list-style-type: none"> <li>• SPD will review inventory and identify any items that could be declared obsolete or surplus. Because of the nature of these items that may need to be destroyed rather than sold as surplus.</li> <li>• Remaining stock will be modified to reflect an accurate location (aisle and bin number) and description</li> <li>• Items will re-inventoried to provide an accurate starting point for future entries</li> <li>• Crib Master will be training the Quartermaster on how to use the software.</li> <li>• After training the software will be used to track purchases and issues.</li> <li>• SPD is negotiating an agreement with Galls (First Responder supplier) to order most of the items currently carried in inventory. This will result in a significantly reduced number of items held in SPD’s</li> </ul>

		accordance with GAAP it is likely that the inventory value was over- or understated.		<p>inventory.</p> <ul style="list-style-type: none"> <li>• Adjustments to inventory will be made by the SPD Fiscal Office, as well as invoice processing.</li> <li>• SPD will continue to provide segregation of duties by having employees other than the Quartermaster receive inventory items. <ul style="list-style-type: none"> <li>a. See Item #1 (above for details)</li> </ul> </li> </ul>
3	<p>Facility</p> <p>Public Works</p>	<p>The storeroom for Public Works (Garage) has issues with security of the inventory. The facility is old and in need of a remodel. It consists of several rooms with varying size, lighting, and shelving. Some items are maintained out in the service area due to size or a lack of space. The City has had contracts for the redesign and remodeling of the Garage area, including the inventory storeroom for several years, but has been unable to proceed due to budgetary issues.</p> <p>The inventory rooms are not physically secured, other than by the presence of a parts specialist. Discussions with management have disclosed that the City is in negotiations with third parties to serve as a parts provider.</p>	<p><b>Enter into a contract</b> for parts supply on an as needed basis.</p> <p>In the event that the City is unable to negotiate a contract for parts supply, and the budget precludes a remodel of the garage and storeroom, we recommend the Department review the existing facility to determine how to reduce the inventory on hand and how to better secure the inventory on hand</p>	<p><b>Public Works: Auditor's Note – This recommendation was conditional upon the City failing to reach an agreement with a vendor to provide parts supply. The City executed a contract on February 18, 2014 with Genuine Parts Company (DBA NAPA Auto Parts) to provide a turn-key, full service and integrated parts room solely managed by NAPA. As part of the contract any alterations to the current facility are the responsibility of the vendor.</b></p>

## EXHIBIT A

### INTERNAL AUDIT RECOMMENDATION PRIORITIES

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

Priority Level <sup>1</sup>	Description	Implementation Action
<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.	Immediate
<b>Medium</b>	A potential for incurring moderate 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 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 of the time frame indicated for each priority level is intended as a target 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 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: SEGREGATION OF DUTIES CONSIDERATIONS

Process/ Role	Control Considerations	If the Answer to Control Consideration is "Yes", Recommend:	Examples of Compensating Controls if Recommendation Cannot be Achieved
<b>Purchasing/ Receiving</b>	<p>Do employees involved in receiving goods from vendor also perform any of the following?</p> <ul style="list-style-type: none"> <li>• Purchase goods (ordering/ cash disbursement)</li> <li>• Record invoices in FMS</li> </ul>	Employees who receive and sign off on goods received should not be involved in the purchasing or cash disbursement process.	Employees who are Custodians and perform receiving duties might order goods if a) order form is sent to Accounts Payable individual, b) signed packing slip is sent to Accounts Payable individual after receipt, and c) invoice is sent directly from vendor to Accounts Payable Clerk. In this structure, Accounts Payable Clerk would perform 3-way match and could follow-up on any merchandise "not received" but invoiced.
<b>Custody/ Access to Inventory</b>	<p>Do employees with custody of and access to inventory have responsibility to perform any of the following?</p> <ul style="list-style-type: none"> <li>• Modify perpetual inventory records</li> <li>• Reconcile physical inventory counts to perpetual inventory records</li> <li>• Reconcile perpetual inventory records to the general ledger inventory balance</li> <li>• Record manual adjustments in the perpetual inventory system</li> </ul>	Employees with access to physical inventory should not be responsible for modifying/ updating/ deleting in the perpetual inventory system or the general ledger.	Modifications to inventory records should be reviewed and approved by a supervisory-level employee on a periodic basis.
<b>Inventory Counts</b>	Are physical inventory counts performed by someone with no responsibility over inventory?	<p>Employees with access to physical inventory (Custodian) should not be responsible for performing inventory counts.</p> <p>Employees with responsibilities associated with the inventory system and reconciliation responsibilities should not be involved in performing physical inventory counts.</p>	<p>If the Custodian/ Reconciler must be involved in the count:</p> <ul style="list-style-type: none"> <li>• 2-person count teams should be utilized.</li> <li>• Spot checks should be completed by supervisory personnel.</li> <li>• Surprise counts should be performed by individuals independent of inventory responsibilities periodically (ie, quarterly) to verify the accuracy of the inventory records.</li> </ul>
<b>Reconciliation</b>	Is the employee responsible for modifying the inventory system also able to reconcile physical inventory counts with the perpetual inventory and/ or the general ledger?	Employees who can modify the inventory system should not reconcile physical inventory counts to the perpetual inventory and/or the general ledger.	The reconciliation should be reviewed/ approved by a supervisory- level employee.

## EXHIBIT C

### INVENTORY COSTING METHODS USED BY CITY DEPARTMENTS

**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. This method is not in accordance with generally accepted accounting principles (GAAP).

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

**First-In-First-Out (FIFO)-** Under this method, the cost of goods sold is based on the cost of the first items purchased, while ending inventory amounts are based on the prices of the most recent items purchased (the last items in). This results in inventory being valued close to current replacement cost.