Office of the City Auditor and Clerk

Fiscal 2009 Physical Inventory Observation
Audit # 10-01
Executive Summary Audit Report

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AUDIT PURPOSE

This audit was included in the 2009-2012 Internal Audit Schedule, and is an annual recurring audit.

AUDIT SCOPE

The audit scope consisted of observing departments' year-end physical inventory counts on an announced basis and reviewing compliance with inventory policies and procedures for the fiscal year ending September 30, 2009.

REPORT CONTENT AND LIMITATION OF USE

Department management is responsible for establishing and maintaining a system of internal controls to adequately safeguard the physical inventory as an integral part of departments' overall internal control structure. The objectives of a system of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposal, and that transactions are executed in accordance with management's authorization on a timely basis.

Due to the inherent limitations in any system of internal accounting controls, errors or irregularities may occur and not be detected in a timely fashion.

Readers of this report are cautioned that an internal audit is not designed to detect all weakness in internal control or accounting procedures as it is not performed continuously throughout the period and the observations noted by Internal Audit are based on the results of sample testing.

AUDIT OBJECTIVES

Internal Audit's overall objective in performing the audit was to assist management with the assessment of internal controls related to issuing, recording, safeguarding and valuing assets. Internal Audit also evaluated departments' degree of compliance with physical inventory instructions provided by the Finance and Accounting Division.

Based on testing performed, Internal Audit rates the attainment of audit objectives at the following ratings:

Audit Objectives	Objective Ratings*		
1. Departments are performing year-end inventory counts in compliance with Finance and Accounting's procedures and/or best practices;		X	
2. Internal controls over inventories are adequate to appropriately restrict access to and safeguard city assets;		X	
3. Access to inventory information systems is appropriately restricted;			X
4. Reported inventory only includes usable or saleable items (and appropriately excludes obsolete or slow-moving items);		X	
5. Inventory cut-off procedures are adequate to ensure that inventory transactions are reported in the correct fiscal year;	X		
6. Inventory amounts are properly reported per financial statements;		X	
7. Management oversight of the physical inventory count and reconciliation process is adequate to ensure adjustments are properly reviewed and authorized.		X	

*Please see Appendix A on **page seven** for further description of rating definitions.

AUDIT TESTING METHODOLOGY

Internal Audit interviewed City employees involved in the inventory process, observed the physical inventory counts or performed post inventory count testing if unable to attend the actual count, evaluated compliance with inventory instructions, performed sample test counts and price verifications, reviewed inventory reconciliations and adjusting journal entries and evaluated management's oversight of the physical inventory reporting process.

BACKGROUND AND STATISTICAL INFORMATION

During fiscal 2009, the following seven city departments or divisions maintained inventory: the Sarasota Police Department, Van Wezel Performing Arts Hall, Public Works, Bobby Jones Golf Club, the Skate Park, the Municipal Auditorium and Payne Park.

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

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 9/30/09	Percent of 2009 Inventory Balance Tested by Internal Audit
Municipal Auditorium and Payne Park	Last Invoice*	Periodic	No	$496	51.5%
Skate Park	Weighted Average	Periodic	No	$1,585	100.0%
Public Works-Utility Stores	Weighted Average	Perpetual	Yes	$63,829	9.4%
Public Works-12th Street Equipment Maintenance	First-In-First-Out (FIFO)	Perpetual	Yes	$122,315	28.19%
Bobby Jones Golf Club Pro Shop	Weighted Average	Perpetual	Yes	$54,151	48.1%
Public Works-Beneva Garage	First-In-First-Out (FIFO)	Perpetual	Yes	$22,135	29.7%
Van Wezel Performing Arts Hall	Last Invoice*	Periodic	No	$4,149	27.5%
Sarasota Police Department	Last Invoice*	Perpetual	Yes	$93,147	6.6%
Public Works-12th Street-Fuel and Oil	Weighted Average	Periodic	No	$9,556	86.3%
Grand Total				**$371,359**	**24.1%**

*The use of last invoice costing is a non-standard costing method, which appears to have resulted in overvalued inventories, as prices have been generally increasing due to inflation over the last several years. Internal Audit did not deem the overall impact from the use of this method, however, as material, in relation to total asset values.

AUDIT OBSERVATIONS AND RECOMMENDATIONS

Internal Audit's observations and recommendations of a medium or high priority level are summarized in the table beginning on **page five**. Internal Audit observations classified as routine in nature do not appear in this report to the City Commission, but have instead been provided directly to the department Directors.

Fiscal 2009 Physical Inventory Observation

Audit # 10-01 Observations, Recommendations and Proposed Management Actions				
Observation/Recommendation/Priority	**Concur**	**Do not concur**	**Proposed Management Action**	**Committed Management Action Date**
1. **Sarasota Police Department Observation-** Segregation of duties concerns were noted with the Quartermaster, who is able to add items, receive items, add/modify prices, and issue items. The Sarasota Police Department relies exclusively on an outside vendor to perform the system administration function, which does not involve its internal Information Technology department, which is both costly and results in overdependence on the vendor. Quarterly review of access logs is not currently being performed. **Recommendation-** Segregate the duties of the Quartermaster to stock keeping (remove ability to add/modify prices). Reassign receiving and pricing function to someone other than the Quartermaster or institute compensating controls. Bring system administration function under IT, document baseline settings and perform quarterly review of access logs to ensure that system security is monitored. **Priority-High**	X		A compensating control will be put in place with respect to the Quartermaster's duties which will segregated to extent currently feasible-another employee or the Support Services Manager will check in and sign when receiving inventory. Dependence on the outside vendor is being addressed. The MIS unit will begin performing a quarterly review of access logs and baseline settings will be documented along with any changes.	6/30/10
2. **Public Works Observation**-Inventory costing parameters are set on an item-by-item basis rather than globally both at the Beneva garage and 12th Street Equipment Maintenance locations, which can result in incorrect or inconsistent inventory values. The system also allows the use of different costing methods for different classes of inventory. There are too many users in the high-level administrative user group resulting in segregation of duties concerns (e.g. Storekeepers can receive, price, count and adjust inventory information). Quarterly reviews of user access logs are not in place. **Recommendation**-Establish global inventory costing parameters in the Cartegraph system and ensure that only one costing method is used for all inventory classes. Limit access in the administrative user group and remove the Storekeeper's ability to enter or modify prices. Perform quarterly reviews of user access logs to ensure that system security is monitored. **Priority-Medium**	X		All inventory items will be under one costing method which will be first in/first out. Access will be limited. The storekeeper will still have access to enter and modify prices; however, supervisor approval will be required for adjustments. A user access log report has been created for Fleet Maintenance and will run quarterly, and be reviewed and signed off by the Public Works Finance and Administrative Manager. The reports will be retained.	6/30/10

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Observation/Recommendation/Priority	**Concur**	**Do not concur**	**Proposed Management Action**	**Committed Management Action Date**
3. **Public Works Observation-**The administrator account had not been disabled and was still in use for the Venice inventory system at the Utilities Division. This system has been scheduled for replacement for several years. Separate UserIDs and passwords are not currently required for this system. Users have clear segregation of duties concerns, as anyone utilizing the administrator account can change prices, delete items and modify the global inventory costing method for all inventory items. Quarterly reviews of user access logs are not in place. **Recommendation-**Prioritize the upgrade to the Cartegraph system (after the issues noted in item #1 above have been corrected), so that security and segregation of duties issues encountered in the Venice system can be resolved. Perform quarterly reviews of user access logs to ensure that system security is monitored. **Priority-Medium**	X		The Utility Stores division is converting from the Venice system to Cartegraph during the month of January, 2010, which will be consistent with the rest of the Public Works Department. All inventory items will be under one costing method which will be first in/first out. All inventory adjustments effective immediately will require Supervisor approval. A user access log has been created for Utility Stores and will run quarterly, be reviewed and signed off by the Public Works Finance and Administration Manager. The reports will be retained.	6/30/2010

APPENDIX A

Internal Audit Rating System

The audit ratings listed below are based on the auditor's assessment of whether the following control objectives have been met:

- Safeguarding of assets,
- Effectiveness and efficiency of operations,
- Reliability of financial and operating information, and
- Compliance with City policies, regulations or rules and/or other governmental laws and regulations.

Red- **A red control objective rating denotes significant business risk or exposure to the City that requires immediate attention and remediation efforts.** The controls reviewed do not appear to provide reasonable assurance that the control objectives are being met. The City is being exposed to a high level of business risk and exposure. Management is advised to immediately review the design and effectiveness of existing controls or consider implementing new or additional controls.

Yellow- **A yellow control objective rating denotes opportunities for improvement exist relating to the controls reviewed.** If this state of control is not improved, it could lead to a higher than acceptable level of business risk or exposure to the City. The controls reviewed provide some, but not sufficient assurance that control objectives are being met. Management is advised to review the design and effectiveness of existing controls or consider implementing new or additional controls on a priority basis.

Green- **A green control rating objective indicates 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.** Controls reviewed appear to provide a high degree of assurance that control objectives are being met. To maintain this rating management is advised to continue to assess the control systems and monitor existing controls for efficiency and effectiveness as business and organizational changes occur.

APPENDIX B

Inventory Costing Method Descriptions

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 first items purchased, and ending inventory amounts are based on the prices of the most recent items purchased (the last items in).

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