

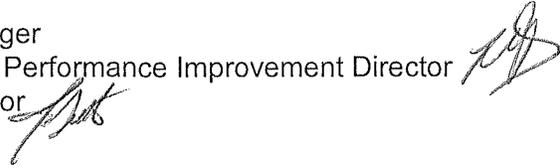


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BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager
VIA: Kathie G. Brooks, Budget and Performance Improvement Director
FROM: James J. Sutter, Internal Auditor



DATE: September 10, 2010
AUDIT: Fleet Inventory Processing
PERIOD: July 1, 2009, through October 23, 2009

This report is the result of an audit performed on the Fleet Inventory Processing, in accordance to our Audit Plan. The Fleet Management Division under its Warehouse Operation unit is responsible for ordering, stocking and issuing automotive parts required for the operation and maintenance of the City's fleet of vehicles and equipment.

INTRODUCTION

The Fleet Management parts warehouse includes a large storeroom for large/bulky parts and excess/reserve parts, and a small storeroom for the most frequently used and more sensitive equipment parts. Warehouse employees receive and issue the parts needed to service City vehicles and equipment from this small storeroom area. The facility also has a shop supplies and consumables area where mechanics find items that are not stocked under inventory control.

The parts warehouse is restricted to warehouse employees, their supervisor, and Fleet Management administrative personnel; keys are required to access the storeroom areas. Fleet mechanics go to an open access area where the storeroom service window is located to request and obtain the parts they need. There are four closed circuit cameras located on the open access area and inside the small storeroom. The cameras are monitored in the Fleet Management Director's office and the images are digitally recorded.

The warehouse inventory stocks the most frequently used parts for the service and maintenance of the City's vehicles and equipment. Many of the parts used for the service and maintenance of the fleet are non-stock, when they are used less frequently or if they have a higher cost. When the purchase of inventory parts is necessary, stock and non-stock, a warehouse employee prepares the order on the Faster System before it is placed with the vendor. The Faster system is a stand alone computer software utilized by Fleet Management for inventory control of automotive parts, mechanics labor, as well as general asset management and fuel consumption tracking. When the parts order is received from the vendor, the warehouse employee checks the units received and the pricing according to the bill of sale. Once the order is verified, the parts are changed from ordered to received in the Faster System, which automatically places them in inventory. Invoices are approved for payment by the Fleet Analyst and forwarded to Finance for payment.

The Fleet Management Director indicated that the re-order point process for stocked parts in inventory is currently being re-evaluated because of the non-performance of warehouse activities by former warehouse personnel, who did not properly reflect purchases and issuances of inventory parts. This took place in the early part of 2009 and resulted in personnel changes, inventory adjustments, and increased supervision. It has taken several months to adjust inventory records and some write-offs have been required. The Director also indicated that stock levels have been

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reduced to prevent over stocking.

The distribution of warehouse parts begins when a work order is opened for repair service or scheduled maintenance of vehicles and equipment, or when warehouse personnel identifies the need to re-order parts. A work order is initially prepared by the Fleet Service Representative (FSR) in the Faster System upon a vehicle complaint/request for service form completed by the person bringing the vehicle for service. A technician is assigned to evaluate the needed repairs and/or perform the required service work. For parts needed, the technician comes to the warehouse and identifies what the work requires. If a non-stock part, a form is completed and the purchase order placed; if the part is in stock, the warehouse employee enters the information in the work order, pulls the part(s) from the storeroom and gives it to the technician. The part number(s) is also entered on a warehouse log sheet and signed by the technician as evidence of receipt. When parts issued are entered on the work order, inventory levels for that part are automatically reduced in Faster.

When the technician completes the work, the FSR is notified and vehicle keys are returned. At this time, the FSR changes the work order status to Ready or Finished, depending whether notification that the work is completed is necessary, or if the vehicle is returned to someone waiting. A copy of the vehicle complaint/service request form is given to the individual receiving the vehicle. At the end of the work day, a Fleet Shop supervisor reviews work orders in Finished status for parts and labor charges and changes the status to Closed. For repairs and service requests considered to be "major" in nature, the area/department requiring the service is notified by email of the estimated costs before the work is actually performed.

Parts used along with labor charges as reflected in the work order, are included in the charge-back amounts reported to Finance on a monthly basis and posted to departmental general ledger accounts. Non-stock parts charges are based on the cost at the time of purchase, while stock part charges represent an average cost based on the last three purchase prices paid for the part. Fleet Management applies a 20% mark-up to the cost of both non-stock and stock parts to cover overhead expenses. For stocked parts, the Faster System calculates an average of the cost for the last three purchase prices in the history of the part. The mark-up percentage is analyzed annually based on (A) the total of warehouse employees' salary and benefits and overhead expenses for the warehouse location and (B) the cost of parts, tires, etc. issued. For example, the 20% mark-up was arrived at by $(A \div B)$, where A= \$140,000 and B=\$700,000.

The annual physical inventory for fiscal year 2009 was delayed due to the implementation of a new bar code/scanning system with PDA (personal digital assistant) units. We were also informed that the parts labels used on the storage shelves had not printed correctly and the PDA scanners could not read the part numbers correctly. Since the PDA technology was being used for the first time to perform physical inventory counts, the label printing problem had not surfaced earlier, thus a new printer had to be obtained and all storage shelves re-labeled. The physical inventory was started on October 23 and concluded on October 26, 2009, resulting in 1,528 distinct parts active in its inventory, 31,054 items in stock, and a value of \$163,990.

Purchases for parts are charged to the Inventory Purchase Warehouse general ledger account (510-4500-000482) under the Fleet Management Fund. During the year, the Fleet Division charges user departments on a monthly basis for parts used. For the fiscal year 2008/09, \$690,700 out of \$695,725 (99.27%) was charged out to the various City departments. While the \$5,025 difference not charged out had a negligible impact on the Fleet Management Fund, the fund still had an operating loss of \$1,586,268 (inclusive of depreciation charges of \$3,237,442). Similar operating losses existed in prior fiscal years resulting in the Fleet Management Fund's Net Assets balance to decrease to \$8,535,794 as report in the City Comprehensive Annual Financial Report for the fiscal

year 2008/09.

OVERALL OPINION

As a result of our testing during the audit we were able to determine that the Fleet Management Division generally maintains an acceptable level of internal controls over the parts inventory warehouse. The warehouse premises and the inventory of parts appear well organized for an efficient warehouse operation. Parts inventory quantities are kept at reasonable levels and parts used are charged back to the respective departments requiring service and maintenance of their vehicles and equipment. However, our testing also identified some deficiencies in reference to the following:

1. A special refurbished radiator kept in stock because of the difficulty to obtain was not included in the Faster System inventory of parts.
2. As a result of the physical inventory counts, 143 parts (9.4%) were found to have differences between the physical inventory counts and the parts inventory levels recorded in the Faster System. There were 70 part numbers where the system count was over the physical counts and 73 parts where the system count was under the physical counts. The over results indicate that parts are missing from the inventory because they may have been issued as part of a work order but not reduced from system records, or they were removed from the warehouse unauthorized.
3. Most of the policies and procedures for the Fleet Management Warehouse are in draft form and in general were not properly dated. We noted other specific deficiencies among the policies and procedures that require updating.
4. The large storeroom in the parts warehouse does not have any security camera coverage on the gate/door leading to a dock area next to the waterway.

Additional details regarding the above mentioned and other areas in need of correction have been provided on the Findings, Recommendations, and Management Responses section of this report.

PURPOSE

The purpose of this audit is to determine whether the Fleet Management Division maintains an adequate level of internal controls over the parts inventory warehouse to ensure these are properly safeguarded, and the receiving and issuing of parts is accurately recorded.

SCOPE

1. Review the adequacy of documented operating policies and procedures to ensure the efficient and effective management of the Fleet parts warehouse.
2. Review the process of purchasing and distributing inventory parts to ensure there is proper segregation of duties.
3. Select invoices of inventory parts purchases and work orders where these parts are issued from the warehouse to evaluate if these are accurately and timely recorded in the Faster System. Determine the adequacy of these processes and their supporting documentation.
4. Select charge-back transactions for Fleet replacement parts and trace the accuracy and posting to their respective general ledger accounts.
5. Verify that warehouse inventory items are stored in an orderly manner, clearly labeled, and

- properly safeguarded.
6. Confirm that adequate procedures were used for conducting the year end inventory in an efficient, effective and timely manner to ensure an accurate count.
 7. Confirm that the year end inventory results accurately reflect the final inventory valuation as determined by the physical count and that this is communicated to the Finance Department.

FINDINGS, RECOMMENDATIONS, AND MANAGEMENT RESPONSES

1. Finding – Parts Inventory Test Count

We performed a parts inventory test count by selecting 101 distinct parts (6.6%): 53 parts with the highest cost/unit and 48 with the highest stock value based on the number of parts times the unit cost. Our sample was selected from the Faster System's Fleet Warehouse Inventory listing of "active" part numbers as of 10/23/09; the same day the physical inventory was started. The warehouse inventory population consisted of 1,526 parts, which included 29,999 items. Of the parts selected by high unit cost we found part #2-4372025, a refurbished radiator that reflected zero items in stock on the inventory listing. This is a special and expensive part that was difficult to obtain when a replacement was necessary, thus Fleet decided to refurbish it at significant savings and keep it in stock, but it was not entered to the Faster System.

Recommendation

We recommend that all parts stocked in the warehouse be included in the Faster System inventory records. This would facilitate locating it as part of the inventory in the Faster System when the time comes to repair the vehicle again, and adding to a work order for charge-back to the department.

Management's Response

Part #2-4372025 [radiator] was refurbished in April of 2008 and placed on a shelf without being properly placed into the inventory. As a result of the 2009 inventory, the part was placed into stock. All parts being stocked in the warehouse whether new, used or refurbished, are now being put into the Faster Inventory System.

2. Finding – Physical Inventory Differences

We reviewed the results of a comparison made by Fleet Management between Faster System inventory records and the PDA (personal digital assistant) inventory counts. This comparison showed initial differences in stock quantities that were subsequently verified by a second count made by the warehouse supervisor to determine if differences were real or if the PDA counts or Faster System records were incorrect. The recount cleared many of the discrepancies; but there were still differences for 143 of the parts. These consisted of 70 part numbers where Faster System records were over the physical counts and 73 parts where system records were under the physical counts. It should be noted that approximately 54 (38%) of the 143 parts were hoses, wires, lubricants, etc., which are not stocked or issued in exact units but rather dispensed in approximate lengths and volume.

The over results indicate that parts are missing from the inventory because they may have been issued as part of a work order but not reduced from system records, or they were removed from the warehouse unauthorized. The lack of accurate recording of parts physically removed from inventory in a work order has an impact in the cost recovery during the charge-back process to departments. The under results reflect that parts purchased and received may not have been entered into the Faster System. The net results for the over/under

differences in inventory levels is estimated to be approximately \$1,269 worth of parts that need to be added to the Faster system.

Recommendation

We recommend that Fleet Management Administration emphasizes to its warehouse personnel the importance of accurately and timely recording transactions in the Faster System for parts received and issued. The methodology used for dispensing and estimating length and volume of parts not issued in exact units should be evaluated to reduce the quantity discrepancies. We further recommend that work orders completed be verified the same day parts are issued to ensure they are properly recorded and charged-back to the departments requiring their use. Periodic test counts should be made of selected part numbers, in a rotating basis, to ensure inventory transactions are being properly recorded and accounted for.

Management's Response

Fleet Management agrees with the recommendations.

The current warehouse team is very aware they are to stock sufficient automotive parts to maintain a high level of service for our customers. The inventory is being continuously monitored and tracked, as to which items are 'moving' and which may soon become obsolete and must be returned. The warehouse staff has recently placed measuring devices as well as log sheets in close proximity to parts which are not issued in exact units (ex: wire, hoses and sash cord). This will help to ensure better accuracy and reduce discrepancies. The Fleet Service Representative and Operations Supervisor are reviewing Work Orders on a daily basis for accuracy. Fleet has implemented a cyclical inventory which is currently in the fourth cycle and reconciles the inventory daily based on purchases and issues of all parts.

3. Finding – Policies and Procedures

We reviewed the policies and procedures for the Fleet Management Warehouse, which included: Physical Inventory Pre & Post Preparation, Fiscal Year End Inventory on Inventory Day Instructions, FasterCS Fiscal Year End Inventory Process, and Special Orders. All of the policies and procedures were provided in draft form, except for the one on Special Orders, and in general were not dated, or did not indicate the year. We also noted the following procedure specific deficiencies:

- a) Physical Inventory Pre & Post Preparation: includes several references to the Internal Audit Department inventory procedures that are no longer applicable.
- b) Fiscal Year End Inventory on Inventory Day Instructions consists of procedures for Inventory Counter, Prepare the PDA (personal digital assistant) for Inventory, PDB (program database) Converter, and Fleet Analyst. We noted that the Inventory Counter procedure describes instructions for inventory counters in teams of two; however, although two counters were used they worked independently.
- c) The Special Orders procedure references a form used for this purpose, but some of the information on the form provided does not correspond with the procedure.

We also requested the policies and procedures used for the daily operations of the parts warehouse, but only received PDF files of the Faster System manual for Parts Processing and Parts Inventory.

Recommendation

We recommend that Fleet Management perform any necessary updates to the policies and procedures of the Fleet Management Warehouse, in order to complete and formalize these documents. All procedures should reflect the most recent revision with month/date/year. In

addition, Fleet Management should develop basic procedures for warehouse personnel on the internal processes to be followed for parts inventory transactions. These procedures should be used in conjunction with the Faster System manual.

Management's Response

Fleet Management recently purchased Hand Held bar code scanners in an effort to become more efficient conducting inventories. Fleet will be updating the inventory procedures to reflect the use of PDA's, cyclic inventories and daily reconciliation of parts purchases and issues. Per the recommendation, the warehouse staff will be updating basic Warehouse procedures and develop additional procedures for material handling as needed to reflect the current operation. All procedures will include revision dates.

4. Finding – Warehouse Security Cameras

We observed the security maintained over the parts warehouse areas and found that the large and inside storeroom areas are restricted by key access to warehouse personnel and Fleet's administration. The area is monitored by four security cameras; two are located on the wall of the unrestricted access area and two on the small/inside storeroom on the wall leading to the large storeroom. Monitors for these cameras are located in the Fleet's Director's office and images are digitally recorded. However, we noted that the large storeroom also has a gate/door leading to a dock area next to the waterway, which does not have any security camera coverage.

Recommendation

To provide adequate security camera coverage to all entrances and exit points of the parts warehouse, we recommend that a security camera for the gate/door leading to the dock area be installed.

Management's Response

Securing the warehouse rear doors in the dock area of the waterway has been extremely difficult. Fleet is currently pursuing additional camera coverage per the recommendation. Fleet will consult with Property Management and the Fire Department for additional solutions.

EXIT CONFERENCE

An exit meeting was held to discuss the audit report and to solicit management responses noted above. Attendees were Andrew Terpak, Joyce Dickerson, James Sutter and Luis López. Management responses were received shortly thereafter. All were in agreement with the contents of this report.

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Audit performed by Luis López, Internal Audit Contractor

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cc: Andrew Terpak, Director, Fleet Management Division
George Fisher, Fleet Analyst
Patricia D. Walker, Chief Financial Officer