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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: July 9, 2009
AUDIT: Property Management Division Inventory Processing Audit
PERIOD: October 1, 2008 – April 24, 2009

This report is the result of a specially requested audit by City Management to review the processes used in the receipt, storage and distribution of inventory by the Property Management Division. Included was a physical count of all inventories that have been charged out to work order code number 1400 (Property Management) and are safeguarded in one of the division's three storage facilities.

INTRODUCTION

The focus of this audit is the Property Management Division which is under the authority of the City Public Works Department. The City's adopted 2007/08 budget book states that *"The Property Management Division is responsible for the operation, maintenance and repair of over 240 municipal buildings and properties, 39 bridges, 3 monuments, 12 water fountains, 3 swimming pools, over 2 miles of Boardwalk, playground equipment, parking garages and street furniture. The Division provides oversight for project development of construction and renovation projects of all City facilities and develops programming, bid specifications, architectural plans and provides construction management for renovation of City facilities. The Property Management Division is responsible for space planning for relocation and renovation of City departments and provides roof surveys, asbestos surveys, and the development of specifications, cost estimates, and contracts necessary for the repair/replacement of all operational equipment, roofs, and building systems. The Division is also responsible for graffiti control throughout the City {for City infrastructure}."*

To assist their staff in the performance of these duties, the Property Management Division has purchase orders with vendors to provide services and materials totaling \$2,476,671.76 for the 2008/09 fiscal year. Examples of approved vendors include A-1 Fire Equipment Company, Home Depot, Marina Plumbing, Oracle Elevator and Zep Manufacturing Company.

A majority of the materials purchased are not included in inventory as they are used immediately after purchase at the designated job site and are charged out to a corresponding four digit work order code number that is specific to a particular location in the City so that the customer can be billed accordingly. Property Management provided a listing of 453 different work order code numbers for such locations as the Bass Museum, each lifeguard stand on the beach, each department/division in City Hall, etc. The purchase, distribution and billing of these materials were not currently audited but will be at a later date.

Instead, we concentrated on the items that were in storage and had been charged out to work order code number 1400 (Property Management) as of 04/13/09, which was when Internal Audit's test counts commenced. These items typically tend to be either commonly used items, fragile items or

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items inadvertently bought in excess that retain their value. Examples of stored inventory include light bulbs, lumber, paint, screws, rain coats, cement, etc.

The Property Management Division maintained the following inventory storage facilities during the audit period:

- a. Electrical hardware (switches, light bulbs, bushings, etc.) is stored on the first floor of the 17th Street Garage, directly south of the Parking Department's offices.
- b. The bullpen is located in a fenced area west of the division's Flamingo Park main offices and is used to primarily safeguard lumber and ladders. The Carpentry Room is in the adjacent area so the entrance gate is left open during normal working hours to allow access as needed.
- c. Three storage containers were positioned directly west of the bullpen in the southwest corner of the parking lot. The easternmost one is used to store hurricane supplies like pre-cut plywood used to protect windows in City buildings while the middle container primarily houses small equipment. The westernmost container is presently the only one that contains such inventoriable items as screws, rope, paint, degreasers, etc.

The 17th Street and storage container were locked and were only accessible to those staff provided keys. Custodians are not present to disburse the inventory at any of the three locations. Instead, supervisors are notified via the radio when inventory is removed and warehouse invoices are prepared listing such relevant information as the date, the work code, job location, items removed, etc. These warehouse invoices are to be submitted to the supervisor during the next business day for his/her review and approval. Afterwards, they are forwarded to division administrative personnel for entry into Datastream 7i, the division's computerized maintenance management system created by Infor Global Solutions Inc., to record all expenses associated with a particular project so that it can be billed correctly. However, additions and deletions to inventory are not presently made into the computer system's inventory module although it has the capability.

The ordering of needed inventory is also done by the supervisors upon notification by the staff or upon his/her site inspections. All parts are received at the division's main offices so that someone is present to inspect it for completeness and to attest to its receipt. Afterwards, the items are transported to either the job site or the appropriate storage facility.

Previously, the Property Management Division maintained a primary warehouse (trailer) at their Flamingo Park facility for the storage of hardware type items used to repair and maintain City owned buildings and structures. During the 2007/08 fiscal year budget process, the storekeeper position was eliminated with the service impact being presented as it would reduce the ability to handle warehouse functions when the storekeeper II position is out on leave. Consequently, the trailer was dismantled at the orders of the previous Division Director during the 2007/08 fiscal year and the inventory process was restructured. The trailer's contents were either issued to staff, moved to the westernmost storage container or were disposed of in a roll-off container and the custodian was assigned to other duties. Selected division personnel were supplied with City issued procurement cards to purchase needed materials and equipment at local hardware and supply stores that would not be found inside the three aforementioned storage locations, which overall carried much less inventory than before.

OVERALL OPINION

The Property Management Division's inventory processes have changed significantly recently with the elimination of the trailer and the custodian's position during the 2007/08 fiscal year by the previous division director. There no longer is the accountability once maintained due to the transition to a more decentralized inventory system with lower carrying balances and increased usage of City issued procurement credit cards at local stores to obtain needed parts. Yet, there remains a need to maintain an inventory of commonly used items, fragile items and items that were initially purchased in excess of those needed for the job's completion and retain their value. Given the relatively low inventory carrying balances, the City Administration should determine the desired safeguards to be implemented and at what price.

In conducting our physical inventory counts and reviewing the internal controls surrounding the inventory, we noted shortcomings in the following areas in need of improvement:

- The division's physical inventory count was not accurately completed as of the fiscal year end (September 30, 2008) and needed to be re-done in April 2009.
- Inventory unit prices are outdated and are not valued in accordance with generally accepted accounting principles.
- Inventory was not adequately safeguarded and accounted for which increases the possibility that successful misappropriations could occur.
- The ordering of inventory is not sufficiently documented and can be inefficient thereby increasing the likelihood that needed parts may not be present as needed. Consequently, parts may have to be purchased at higher on-shelf prices, temporarily delaying work's completion, etc.
- Updated policies and procedures do not presently exist that accurately reflect current inventory processes.

PURPOSE

The purpose of this audit is to determine whether inventory items were purchased in accordance with Procurement rules; whether transactions are economically and efficiently processed, accurately and promptly recorded, reported, followed up; whether City assets and key forms, records, files and systems are properly safeguarded and controlled, and access thereto is restricted in accordance with management's criteria; and whether final disposition of these properties was in compliance with division policies and procedures.

OBJECTIVES

1. Confirm that documented operating policies, standards and procedures exist to ensure efficient and effective administration of the warehouse and that there is compliance with these policies, standards and procedures, as well as all laws and regulations.
2. Confirm that warehouse inventory items are stored in an orderly manner, are clearly labeled, are properly safeguarded and are reasonably valued.
3. Confirm that the physical inventory was performed in an efficient, effective and timely

manner with sufficient personnel and adequate procedures to ensure an accurate count.

4. Confirm that the final inventory report accurately reflects the final inventory valuation as determined by the physical count.
5. Confirm that proper segregation of duties exists and that all tested inventory transactions (addition and removal) were accurately valued, approved and processed.
6. Confirm that well organized, complete and sufficient documentation is maintained to adequately support all tested transactions.

Our audit scope did not include a review of the division's billing process which charges out costs for performing work conducted by staff to other user departments/divisions as it is currently being reviewed through this year's budgetary process.

SCHEDULE OF TESTED ITEMS COUNTED BY STORAGE LOCATION

STORAGE LOCATION	TOTAL NUMBER OF ITEMS	TOTAL NUMBER TESTED	PERCENT TESTED (NUMBER)	TOTAL VALUE OF ITEMS	TOTAL VALUE TESTED	PERCENT TESTED (VALUE)
17 th Street Garage *	749	60	8.01%	\$90,604	\$13,723	15.15%
Storage Container **	303	303	100.00%	\$37,444	\$37,444	100.00%
Bullpen **	56	56	100.00%	\$7,995	\$7,995	100.00%
Total	1,108	419	37.82%	\$136,043	\$59,162	43.49%

* All tested 17th Street Garage items were randomly selected from the 04/13/09 report provided by Property Management's Office Associate V showing the results of the recent physical inventory count by storage location. The percentage tested was judgmentally determined due to the current organization of the inventory parts being stored and the results of previously performed inventories at this location.

** All items in the storage container and bullpen (100%) were counted due to inaccuracies in Property Management's initial physical inventory count and to expedite the audit's completion time.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Finding: Physical Inventory Count

The Property Management Division is to perform a physical inventory at fiscal year end to calculate and report the corresponding valuation to the Finance Department so that the division's inventory asset account can be updated in the City's general ledger (account number 520-7000-141000). An inventory report run on 09/19/08 totaling \$186,353.73 was submitted to the Finance Department on 01/16/09 and entered into the City's Financial System.

Internal Audit's subsequent review of this submitted inventory report found it to be inaccurate as it included \$68,445.92 in inventory in the trailer. It was known that the trailer and its contents were disbursed to the staff for use in the completion of their duties, moved to the westernmost storage container to be safeguarded until needed or disposed of in a roll-off container prior to 09/30/08 per the previous Division Director's instructions. Internal Audit

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was unable to determine whether only obsolete items were disposed of and that all inventory of value was maintained. The Finance Department was notified of the overstatement and the 2007/08 fiscal year end inventory balance was reduced by \$68,445.92 through journal entry 12-126.

Another physical inventory count was performed in April 2009 as part of this audit with Internal Audit conducting test counts to verify its accuracy. The physical counts for the 17th Street Electrical Room were completed and variances existed for 10% of the items sampled (6/60) resulting in an understatement of inventory of \$895.64 with one item accounting for 90% of the difference in value. These six items were recounted by the Electrical Supervisor and a consensus was reached as to the correct quantity.

Meanwhile, the initial April 2009 physical counts for the bullpen and storage container were deemed inaccurate and a full inventory recount was subsequently completed by Property Management staff and Internal Audit. The following deficiencies were noted which most likely contributed to the inaccuracies of Property Management's initial April 2009 inventory count:

- a. Some items, especially those in the bullpen, were commingled making it difficult to obtain an accurate count. Therefore, the possibility exists that items may have been counted twice or added to an incorrect part number with a different unit price thereby distorting the total inventory valuation.
- b. Needed parts were removed during the inventory but documentation was not maintained to show if it was before or after the item was physically counted so that the corresponding count could be increased or decreased.
- c. The designated staff appeared to have searched for the items on the provided inventory report and only counted those items. As a result, a number of items present in these storage areas but that were not listed on the report were not recorded.

The following table lists the inventory report dates, and amounts by storage facilities for the three different Property Management inventories conducted since September 2008 by storage facility:

	09/19/08	04/02/09	04/20/09
A/C Shop	\$1.00	\$1.00	\$0.00
Electrical 17 th Street Garage	98,427.61	77,708.50	90,603.53
Electrical Hurricane	1,182.78	0.00	0.00
Electrical Shop	2,209.43	0.00	0.00
Bullpen	9,480.48	9,412.05	7,995.04
Inventory Shop	6,606.51	6,606.51	0.00
Inventory Trailer	68,445.92	68,445.92	37,443.52
MT-Carpenter	0.00	0.00	0.00
Plumber's Shop	0.00	0.00	0.00
Total Inventory	\$186,353.73	\$162,173.98	\$136,042.09

Recommendation(s):

The Property Management Division should properly conduct their inventory at fiscal year end so that the figures reported to the Finance Department are correct and timely. Before the

physical count is performed, the inventory should be organized with similar items grouped together and any obsolete items discarded. Advance notice should be given to the staff so that inventory is not received or disbursed of during the physical count unless approved by designated supervisors. Those employees performing the inventory should physically count all items present and then record them. If the item does not appear on the inventory report, then it should be added.

Management Response:

Pricing has been completed and submitted. Future inventory counting will be conducted as in previous years by physical count, recorded by physical count with current pricing and will be submitted to Finance in a timely manner.

2. Finding: Inventory Valuation

The Property Management Division's inventory report listed unit prices are based on prices obtained several years ago when the items were initially purchased and have not been adjusted. These unit prices remain constant each year and are not updated to reflect current prices paid for new goods ordered. As a result, reported inventory may be over or undervalued and is not valued in accordance with generally accepted accounting principles.

Inquiries to the City's Finance Department resulted in the instruction to value the prices at the last price paid for each item. The Division attempted to seek the latest price paid for each item; however they encountered difficulty in tracking down the respective invoices for pricing. It was later agreed to seek current market prices using vendor price listings in order to arrive at a fair value for the inventory. The Division's Assistant Director was informed of the need to update unit prices before submitting the finalized inventory report. These updated prices were subsequently received and incorporated into the division's submitted inventory report so that the reported values more accurately approximate current market values.

Recommendation(s):

Under the current scenario, the Property Management Division should update their inventory unit prices during each year end physical count to better equal the current market value. If the division opts to switch to a perpetual inventory system in the future whereby inventory is added upon receipt and removed from Datastream 7i when disbursed, then they should value the inventory consistently in accordance with selected accounting principles (weighted average, Last In First Out, First In First Out, specific identification, etc.).

Management Response:

Prices have been updated in the inventory system. Training will be conducted to ensure proper accounting principles are used for inventory values.

3. Finding: Safeguarding Assets

In its current format, the Property Management Division does not possess sufficient control over the custody of its inventory due to the number of employees with keys as well as the lack of custodians, cameras, alarms, etc. Furthermore, the lack of a perpetual inventory system and/or subsequent reconciliation by an independent employee of purchases, disbursements and end of the year carrying amounts makes it difficult to determine the level of shrinkage (if any). The division's software system, Datastream 7i, is presently underutilized as it also has the ability to bar code inventories, assist in the ordering of parts and equipment, etc.

The Maintenance Supervisor mentioned future plans during the audit to cordon off the bullpen from the adjoining Carpentry Room and the corresponding assignment of a custodian during the early morning and lunch hour when most inventories are disbursed. This custodian would also disburse inventories as needed from the nearby storage container. The existing locks protecting these storage facilities would be changed so that only the custodian and supervisors would have the keys to access this inventory. This practice if implemented would better safeguard the inventory stored in the bullpen and storage container.

Recommendation(s)

Given current inventory carrying balances, the Property Management Division should determine the cost effectiveness of implementing additional safeguards. At a minimum, Internal Audit believes that the maintenance of a perpetual inventory system on Datastream 7i with annual reconciliations should be implemented.

Another option to be considered is to move the 17th Street electrical inventory to one of the remaining storage containers so that it can also be maintained by the aforementioned part time custodian. The hurricane supplies and/or small equipment presently stored there, which is not used much, could be moved to the 17th Street storage facility.

The option of consolidating Property Management's inventory with the Public Works Warehouse currently being discussed by the City Administration is also feasible. However, great care must be taken to keep this inventory separate from the water and sewer inventory purchased with bond monies so as not to jeopardize the City's bond rating.

Management Response:

Currently, the maintenance inventory is being issued by a Carpenter under the supervision of the Maintenance Supervisor and the electrical inventory is managed under the supervision of the Electrical Supervisor. Property Management plans to bring back the Storekeeper II to maintain the inventory input in the Datastream 7i system and the Administration office is handling the input of inventory invoices and output of materials to work orders. The Storekeeper will handle the end of the fiscal year inventory count.

The electrical inventory will be moved to the new Property Management location once the move to the Sunset Harbour location is ready and all inventories will be handled at the new site.

4. Finding: Ordering Inventory

The Maintenance and Electrical Supervisors are responsible for ordering inventory for their respective storage facilities. Ordering is primarily done either upon notification by staff or after self-observation that inventory levels for a particular item are low or non-existent. This process is relatively simplistic but functional in lieu of not having a perpetual inventory system whereby Datastream 7i could send alerts to order items once inventory levels fall below designated thresholds. However, a downside to the current process is that the flow of communication with staff must remain open or items might not be ordered timely resulting in temporary stock-outs and/or work stoppages.

Recommendation(s):

Staff should document their request in writing to their supervisors to have inventory items

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ordered. Also, Datastream 7i should be used as a perpetual inventory system whereby inventory is added as received and deleted as disbursed to work orders so that inventory carrying balances can be continually known.

Management Response:

Training on inventory and stock balances will need to be held in order to better manage purchases and make sure needed stock is in inventory to keep the costs down.

5. Finding: Policies and Procedures

Although the Property Management Division updated their warehouse operations procedures in 2005 as part of their accreditation process, such material inventory process changes as the elimination of the trailer and custodian position, the transition from a perpetual to a periodic inventory system, etc. have occurred in the interim. Consequently, the listed procedures do not currently accurately reflect present operations.

Recommendation(s):

The Property Management Division's operating policies and procedures should be updated as soon as possible to more descriptively outline current inventory processing operations. Policies and procedures serve both as a benchmark to measure individuals' performance and as an instruction manual in the event employees' change. Once completed, they should be distributed to all applicable personnel so that they can be read and followed.

Management Response:

Property Management will update the policies and procedures for the inventory processing operation and will distribute these updated procedures to all personnel.

EXIT CONFERENCE

An exit conference was held on July 7, 2009 in OBPI's Conference Room. Participants included Acting Property Management Division Director John Toledo, Office Associate V Madeline Reisler, Internal Auditor James Sutter and Senior Auditor Mark Coolidge. Audit findings and recommendations were discussed, as were management responses, which are included herein. All were in agreement with the contents of this audit report.

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(Audit performed by Mark Coolidge)

cc: Tim Hemstreet, Assistant City Manager
Fred Beckmann, Public Works Director
John Toledo, Acting Property Management Division Director
Patricia Walker, Chief Financial Officer