
AGREED-UPON PROCEDURES RELATED TO THE CENTRAL STORES PHYSICAL INVENTORY

Office of the City
Auditor

City of San Diego





THE CITY OF SAN DIEGO

DATE: September 4, 2018
TO: Kristina Peralta, Director, Purchasing and Contracting
FROM: Eduardo Luna, City Auditor, Office of the City Auditor
SUBJECT: Agree-Upon Procedures Related to the Central Stores Physical Inventory – FY18

Enclosed is the Agreed-Upon Procedures Related to the Central Stores Physical Inventory for Fiscal Year Ending 2018 conducted by Macias Gini & O'Connell (MGO). This inventory count is required by San Diego Municipal Code §22.0501. The report contains the procedures and results of work completed by the MGO, and is provided for informational purposes only. MGO made two recommendations. Your response to the audit is presented after page 6 of this report.

We would like to thank MGO for their work, and the Purchasing & Contracting Central Stores staff for their assistance and cooperation during this audit.

Respectfully submitted,

Eduardo Luna
City Auditor

cc: Honorable Mayor Kevin Faulconer
Honorable City Councilmembers
Honorable Audit Committee Members
Kris Michell, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Rolando Charvel, Chief Financial Officer
Ron Villa, Deputy Chief Operating Officer, Internal Operations
Tracy McCraner, Department of Finance Director and City Comptroller
Andrea Tevlin, Independent Budget Analyst
Matthew Helm, Deputy Director, Purchasing and Contracting
Thomas Sawade, Stores Operations Supervisor

CITY OF SAN DIEGO

Independent Accountant's Report on Applying
Agreed-Upon Procedures Related to the
Central Store Physical Inventory

June 30, 2018



Certified
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CITY OF SAN DIEGO
Independent Accountant's Report on Applying
Agreed-Upon Procedures Related to the
Central Store Physical Inventory

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Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Office of the City Auditor
of the City of San Diego
San Diego, California

We have performed the procedures enumerated below, which were agreed to by the Office of the City Auditor (City Auditor) of the City of San Diego (City), solely to assist the City Auditor's compliance with the requirements of Article 2, Division 5, Section 22.0501 of the San Diego Municipal Code regarding the City's Central Store inventory records as of June 30, 2018. The Purchasing and Contracting Department (the Department) is responsible for the City's Central Store inventory records. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

- 1) Obtain an electronic version of the Central Store inventory stock records as of June 26, 2018 maintained by the Purchasing and Contracting Department and select a sample based on a 99% confidence level and 8% confidence interval.

Result: We obtained an electronic version of inventory stock records maintained by the Purchasing and Contracting Department for the Central Store, which contained a total of 1,274 stock items. Per concurrence with the City Auditor at the entrance conference held on June 20, 2018, paper-form stock items were excluded from the sampling population, resulting in a total of 1,159 stock items – the Central Store had 115 paper-form stock items.

- 2) Conduct physical inventory count at the Department's Central Store location for the randomly selected sample items and compare the results of the physical inventory count to the Department's inventory stock records. The physical count includes opening a judgmental portion of the inventory boxes for the sample items selected to verify the contents.

Result: Refer to Attachment 1 (which reports the results for both Procedures 2 and 3) for a summary of the results of the physical inventory count and Attachment 2 for a detail listing of the inventory stock item discrepancies.

- 213 stock items were randomly counted at the Central Store with a recorded inventory value of \$317,112. Of the 213 stock items counted, MGO noted discrepancies for 42 stock items. 29 of the stock items resulted in an overstatement of 1,015 inventory units, or \$3,997, which were included per the inventory record system but not on hand. 13 of the stock items resulted in an understatement of 177 inventory units, or \$814, which were on hand, but not included in the inventory record system. The net impact of items counted at the Central Store is an overstatement in the inventory record system of \$3,183.

During the observation counts, MGO noted that Central Store does not have formal documentation of its policy and procedures for the inventory cycle counts. MGO recommends the implementation of formal policy and procedures of planning and executing systematic inventory counts.

In addition, MGO recommends that the Purchasing and Contracting Department consider procuring handheld devices that are compatible with the SAP inventory record module. These devices can be used to scan the barcodes that already exist on each stock item tag and will allow storekeepers to update inventory records in real-time for their inventory cycle counts.

- 3) Judgmentally select 10 items on hand at the Central Store and compare the items to the inventory system stock records to verify if they are accurately recorded in the inventory system.

Result: Refer to Attachment 1 (which reports the results for both Procedures 2 and 3) for a summary of the results of the physical inventory count and Attachment 2 for a detail listing of inventory stock item discrepancies.

- Judgmentally selected and counted 10 stock items on hand at the Central Store with a recorded inventory value of \$27,709. Of the 10 stock items counted, MGO noted discrepancies for 3 stock items. 2 of the stock items resulted in an overstatement of 10 inventory units, or \$301, which were included per the inventory record system but not on hand. 1 of the stock items resulted in an understatement of 1 inventory unit, or \$12, which was on hand but not included in the inventory record system. The net impact of items counted at the Central Store is an overstatement of the inventory record system of \$289.

- 4) Inquire with the Store Manager regarding the Central Store procedures and activities to ensure obsolete inventory (inventory with no sales to the City departments during the prior fiscal year) is annually reviewed. Verify if the Department's justification for retaining obsolete items is maintained on file, or if obsolete inventory is being properly liquidated.

Result: Per inquiry with the Central Store Operations Supervisor, obsolete inventory is reviewed annually by the Purchasing and Contracting Department. Stock items in the inventory records without goods movement within the last 12 months are identified in SAP by Central Store staff. The Purchasing and Contracting Department attaches a listing of items identified from SAP to a memo that is sent to each respective department, requiring their review of the items identified and a response within 30 days. In their response, departments provide justification for retaining obsolete items or disposing of them. Obsolete stock items identified by the departments are removed from the inventory records by Central Store staff and set aside for disposal. During the inventory count at the Central Store on June 27 and 28, 2018, we observed that all obsolete items were appropriately segregated from moving stock items.

- 5) Determine if the recommendations from the FY 2017 Inventory agreed-upon procedures have been adequately implemented to resolve the identified issues.

Result: There were no recommendations from the FY 2017 Inventory agreed-upon procedures. As such, this procedure does not apply for FY 2018.

- 6) Provide the results of the inventory counts and the results of the obsolete inventory review in a draft written report with recommendations, as appropriate, to address any identified issues.

Result: The results of the physical inventory count for the Central Store were provided to the Department on August 9, 2018.

- 7) Hold an exit conference with Purchasing and Contracting Department staff and City Auditor staff to review and finalize the draft report.

Result: An exit conference was held with Purchasing and Contracting Department staff and City Auditor staff on August 9, 2018 to review and finalize the draft report.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the Central Store inventory records maintained by the Department. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the City Council and Audit Committee of the City of San Diego, the City Auditor, and the Purchasing and Contracting Department of the City of San Diego and is not intended to be and should not be used by anyone other than those specified parties.

Macias Gini & O'Connell LLP

San Diego, California
August 29, 2018

Attachment 1

Location	Total Number of Stock Items in Inventory Records¹	Total Inventory Value²	Total Number of Sampled Stock Items³	Total Value of Sampled Stock Items	Number of Inventory Units Over / (Under) in the Inventory Records	Total Value of Inventory Units Over / (Under) in the Inventory Records	Percentage Difference Between the Value of Sampled Items Counted and Total Value of Sampled Inventory as Recorded in the Inventory Records	Estimated Difference in the Total Inventory Value per the Department's Stock Records Based on the Sampling Error
Chollas	1,274	\$ 1,379,249.24	223	\$ 344,821.00	1,025 (178)	\$ 4,298.11 (825.83)	1.25% -0.24%	\$ 17,192.01 (3,303.24)
Total	1,274	\$ 1,379,249.24	223	\$ 344,821.00	847	\$ 3,472.28	1.01%	\$ 13,888.77

¹The "Total Number of Stock Items" is as of June 26, 2018, based upon the Purchasing and Contracting Department's inventory stock records including the various forms maintained in inventory, which were excluded from our sampling population.

²The "Total Inventory Value" is as of June 26, 2018, based upon the Purchasing and Contracting Department's inventory stock records.

³The "Total Number of Sampled Stock Items" refers to the number of separate stock items physically counted pursuant to Procedures #2 and #3.

Attachment 2 Chollas Store

PROCEDURE 2 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Inventory Value	Unit Value	Number of Units Recorded in SAP	Inventory Unit of Measure	Number of Units Per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory Value Overstated/ (Understated) in SAP
1	22010869	CAPSCREW NC 5/8" X 2-3/4" 25/PACK	\$ 51.06	\$ 0.37	138	EA	76	62	\$ 22.94
3	22014645	CONE SLEEVE 4" REFLECTIVE PRESS MOUNTED	309.35	3.12	99	EA	-	99	309.35
4	22014664	COVERALL KLEENGUARD W/O HOOD XXL 44315	1,086.75	1.67	649	EA	625	24	40.19
5	22014736	GLOVE RUBBER SLVRS FL/LIN XLG 12PK-144CS	258.81	0.90	288	PR	252	36	32.35
6	22014808	HAT STRAW SUN-PROTECTION W/SWEAT BAND &	303.06	12.12	25	EA	-	25	303.06
7	22014986	RAINCOAT - PLASTIC YELLOW XXLARGE	9.46	4.73	2	EA	-	2	9.46
8	22015010	ROPE MANILA 1/2",600'/SPOOL	132.34	0.24	557	EA	-	557	132.34
9	22015046	SHIELD FACE CLEAR 8X15X.040THICK	595.61	1.46	409	EA	384	25	36.41
10	22015054	SIGN SLOW-STOP,REFLECTIVE	99.14	33.05	3	EA	-	3	99.14
11	22015954	BUSHING BRASS IPS 125-PSI 1/2" X 3/8"	103.07	2.19	47	EA	35	12	26.32
12	22016135	BIB HOSE BRASS S.O.T 3/4" MALE NO LEAD	9.16	4.58	2	EA	1	1	4.58
13	22016274	NIPPLE BRASS 1/4" X CLOSE NO LEAD	28.65	0.73	39	EA	40	(1)	(0.73)
14	22016350	NIPPLE BRASS 2" X 6"	86.94	14.49	6	EA	1	5	72.45
15	22016352	NIPPLE BRASS 2" X 10"	119.99	24.00	5	EA	6	(1)	(24.00)
16	22016425	VALVE ANG 2" PVC COMPX MTR FLG NO LEAD	338.89	169.45	2	EA	-	2	338.89
17	22018749	PIPE PVC SCH40 1-1/2" X 20'	83.91	0.71	118	FT	120	(2)	(1.42)
18	22018951	COUPLING PVC SCH40 SLIP X SLIP 1/2"	2.72	0.25	11	EA	13	(2)	(0.49)
19	22019963	PIPE GALVANIZED 3/4" X 21' FT.	3,846.68	24.82	155	EA	159	(4)	(99.27)
20	22025678	CLAMP REPAIR SS BAND 8" X 16 W/2" IP TAP	3,083.80	171.32	18	EA	17	1	171.32
21	22025708	CPLNG ENDCAP CI&AC ME 6" 2" FIP 6.90-7.35	1,554.78	91.46	17	EA	19	(2)	(182.92)
22	22025891	COVER METERBOX 1-1/2"-2" #SDW113 POLYCON	15,780.72	66.31	238	EA	236	2	132.61
23	22030089	Hook - Meter Box	271.61	67.90	4	EA	1	3	203.71
24	22030388	SCREWDRIVER FLAT TIP 6" PLASTIC HANDLE	76.78	5.12	15	EA	14	1	5.12
26	22030444	SNIPS AVIATION STANLEY FMHT 73756	44.39	14.80	3	EA	4	(1)	(14.80)
27	22030482	SOCKET SHT 12PT 3/4X1 13/16 BLKHWK 60058	38.30	38.30	1	EA	-	1	38.30
28	22031030	NOZZLE TIP,3/4"GT X 1/4"ORIFACE;	32.17	10.72	3	EA	1	2	21.45
29	22032912	BALLAST 50W 120/277V HPS ADV 71A7801001	442.09	73.68	6	EA	-	6	442.09
30	22035131	PAINT ENAMEL INDUSTRIAL FORREST GREEN 1GAL	818.77	43.09	19	EA	20	(1)	(43.09)




THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: September 4, 2018

TO: Honorable Councilmember Lori Zapf and Audit Committee Members

FROM: Kristina Peralta, Director, Purchasing & Contracting
via Ronald H. Villa, Acting Assistant Chief Operating Officer 

SUBJECT: Management Response to the *Independent Accountant's Report on Applying Agreed-Upon Procedures Related to Central Stores Physical Inventory*

The purpose of this memorandum is to provide Management's response to the findings and recommendations in the June 30, 2018 report titled *Independent Accountant's Report on Applying Agreed-Upon Procedures Related to the Central Stores Physical Inventory*. Additionally, we provide information on our ongoing efforts to strengthen inventory control, standardize operating procedures, and minimize physical inventory discrepancies in Central Stores stock.

As of February 2018, Central Stores successfully completed the consolidation of the two stores facilities into one location. The goal of the consolidation was to reduce facilities operating expenses, improve warehouse efficiency, and eliminate redundancies in inventory between the two warehouse locations. The consolidation required a significant build-out of the warehouse to accommodate staff relocation and involved the physical and digital transfer of over \$500,000 in inventory. This year marks the first physical inventory audit of Central Stores' consolidated operations.

As noted in the report, there were no recommendations from the FY 2017 agreed-upon procedures audit for follow-up in the FY 2018 report. Additionally, the report notes that the FY 2018 obsolete inventory process was carried out timely, and that obsolete items were appropriately segregated from moving stock items (issues that were raised in the FY 2016 report).

The Independent Accountant's Report sets forth two recommendations under Agreed-Upon Procedure 2. Management's response to the recommendations are below.

Recommendation 1: "During the observation counts, MGO noted that Central Store does not have formal documentation of its policy and procedures for the inventory cycle counts. MGO recommends the implementation of formal policy and procedures of planning and executing systematic inventory counts."

Management Response: Agree. Prior to the consolidation of the Central Stores facilities into one location, SAP system-generated cycle count configurations differed between the two Stores locations due to a systems issue. As a result, Stores staff implemented an ad-hoc,

manual process of doing rolling inventory counts on segments of the inventory on a regular basis. As noted above, Central Stores completed the consolidation of two warehouse facilities into one location in February 2018. Consolidation of the inventory into one location caused disruptions to the rolling inventory process. Following the completion of consolidation activities, Purchasing & Contracting engaged the Department of Information Technology's Enterprise Resource Program to utilize different SAP functionality to establish systematic cycle counts. Consistent with industry best practices, the cycle counts will be optimized based on frequency of inventory turnover and dollar value. Additionally, Central Stores staff have implemented a revamped inventory bin location assignment system, which will enable the automated cycle counts to be conducted more quickly and accurately. After the configurations are finalized, Stores staff will formalize procedures for cycle counts and train staff on the revised processes.

Timeframe for Completion: Configuration tasks are underway and Central Stores will have associated procedures and training completed by March 29, 2019.

Recommendation 2: "In addition, MGO recommends that the Purchasing and Contracting Department consider procuring handheld devices that are compatible with the SAP inventory record module. These devices can be used to scan the barcodes that already exist on each stock item tag and will allow storekeepers to update inventory records in real-time for their inventory cycle counts."

Management Response: Agree. Management is open to considering all options to increase the efficiency of the Store's inventory management. Management will consider investing in handheld scanning devices and software that integrate with SAP, subject to budgetary and technological integration considerations.

Timeframe for Completion: Management will make a determination regarding the acquisition of handheld devices by March 29, 2019.

In addition to the Management responses above, observations regarding other results of the agreed-upon procedures findings are discussed below.

The extrapolated error rate and extrapolated dollar value of errors increased from FY 2017 to FY 2018. Data from the FY 2016 – FY 2018 audits are summarized below for comparative purposes.

Fiscal Year	Extrapolated Error Rate (% difference between value of sampled items counted and sampled items in inventory)	Extrapolated Value of Errors (estimated \$ difference in the total inventory value based on sampling error)
2016	1.1%	\$24,055
2017	0.91 %	\$4,831
2018	1.01%	\$13,889

Error rates and the associated dollar values of the error rates increased from FY 2017 to FY 2018, but remained below FY 2016 levels. As with audits conducted in previous years, Purchasing & Contracting management and Stores supervisors reviewed each of the discrepancies identified in the Independent Accountant's report. For each of the

discrepancies identified in the report, Stores supervisors were able to identify the root causes of the errors and rule out theft or other types of inventory loss. Key error issues and associated remediation steps are summarized below:

Error Issue 1 – Receiving Errors: Several discrepancies were connected to staff incorrectly keying in inventory shipments from vendors upon arrival to Central Stores. Specifically, the requirement to reconcile vendor packing slips to purchase order documents was not consistently followed. As a result, some incomplete inventory shipments were keyed in as complete shipments.

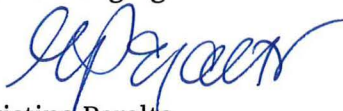
Remediation Plan: The identified errors of this type have been corrected in SAP. However, the inconsistent practices that resulted in the errors point to a need for staff training on the issue. Central Stores supervisors are developing standard operating procedures for inventory receiving, which will require staff to document that packing slips are reconciled against purchase orders. Central Stores staff responsible for inventory receiving will be trained on the procedure and adherence to the process will be incorporated into staff performance plans.

Error Issue 2 – Issuing Errors: Several discrepancies were connected to inventory being issued and recorded in SAP with the incorrect quantity or unit of measure. For example, a case of 24 overalls was recorded as “1” issued in SAP, rather than 24.

Remediation Plan: The identified errors of this type have been corrected in SAP. Central Stores staff are developing standard operating procedures to require the systematic verification of units of measure and quantities for all stock issued to customers. The procedure will require staff to block time at the end of each shift to verify stock has been issued in the correct amounts and recorded accurately in SAP. Central Stores staff responsible for issuing stock will be trained on the procedure and adherence to the process will be incorporated into staff performance plans.

Error Issue 3 – Inventory Adjustments: The process for making adjustments to inventory records in SAP after identifying errors during cycle counts was inconsistent and did not require supervisory approval. Discrepancies as a result of incorrect inventory adjustments highlighted the need for staff training on the issue.

Remediation Plan: Central Stores supervisors have already developed and implemented a standard operating procedure, and currently all inventory adjustments require documented approval from a supervisor, along with a documented justification for the adjustment. All staff were trained on the procedure in July 2018, and staff have signed a document acknowledging understanding of the adjustment process.



Kristina Peralta
Director, Purchasing & Contracting Department

cc: Stacey LoMedico, Assistant Chief Operating Officer
Rolando Charvel, Chief Financial Officer
Tracy McCraner, Comptroller and Department of Finance Director