
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: October 3, 2016
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 – FY16

Enclosed is the Agreed-Upon Procedures Related to the Central Stores Physical Inventory for Fiscal Year Ending 2016 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 and you agreed with both recommendations. Your response to the audit recommendations are presented after page 7 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
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Rolando Charvel, 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 Stores Physical Inventory

June 30, 2016



Certified
Public
Accountants

CITY OF SAN DIEGO
Independent Accountant’s Report on Applying
Agreed-Upon Procedures Related to the
Central Stores Physical Inventory
For the Fiscal Year Ended June 30, 2016

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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 Stores inventory records as of June 30, 2016. The Purchasing and Contracting Department (the Department) is responsible for the City's Central Stores inventory records. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. 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 Stores (Store 1 and Store 2) inventory stock records maintained by the Purchasing and Contracting Department and select a sample, by storeroom, 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 Store 1 and Store 2, which contained a total of 1,421 and 1,662 stock items, respectively. Per concurrence with the City Auditor at the entrance conference held on June 16, 2016, paper-form stock items were excluded from the sampling population, resulting in a total of 2,710 stock items – Store 1 had 1,068 stock items and Store 2 had 1,642 stock items. Using a 99% confidence level and 8% confidence interval resulted in a total sample size of 237. The sample size was allocated between Store 1 and Store 2 based on the dollar value of the sampling population (excluding paper-form stock items). We randomly selected 93 stock items from Store 1 and 144 stock items from Store 2.

- 2) Conduct physical inventory counts at the Department's Store 1 and Store 2 location for the randomly selected sample items and compare the results of the physical inventory counts 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.

- 93 stock items were randomly counted at Store 1 with a recorded inventory value of \$85,683. Of the 93 stock items counted, MGO noted discrepancies for 12 stock items. 7 of the stock items resulted in an overstatement of 58 inventory units, or \$568, that were included per the inventory record system.

5 of the stock items resulted in an understatement of 23 inventory units, or \$701, which were on hand, but not included in the inventory record system. The net impact of items counted at Store 1 is an understatement in the inventory record system of \$133.

- 144 stock items were randomly counted at Store 2 with a recorded inventory value of \$84,801. Of the 144 stock items counted, MGO noted discrepancies for 30 stock items. 22 of the stock items resulted in an overstatement of 543 inventory units, or \$2,939, that were included per the inventory record system. 8 of the stock items resulted in an understatement of 33 inventory units, or \$1,234, which were on hand, but not included in the inventory record system. The net impact of items counted at Store 2 is an overstatement in the inventory record system of \$1,705.

- 3) Judgmentally select 10 items on hand at Store 1 and Store 2 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 Store 1 with a recorded inventory value of \$102,445. Of the 10 stock items counted, MGO noted discrepancies for 5 stock items. 3 of the stock items resulted in an overstatement of 13 inventory units, or \$1,404, that were included per the inventory record system. 2 of the stock items resulted in an understatement of 7 inventory units, or \$1,431, which were on hand but not included in the inventory record system. The net impact of items counted at Store 1 is an understatement of the inventory record system of \$27.
 - Judgmentally selected and counted 10 stock items on hand at Store 2 with a recorded inventory value of \$95,113. Of the 10 stock items counted, MGO noted discrepancies for 2 stock items. The 2 stock items resulted in an overstatement of 2 inventory units, or \$2,488, that were included per the inventory record system.
- 4) Inquire with the Store Manager regarding the Central Stores 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 Stores Operations Supervisor, obsolete inventory is reviewed annually by the Purchasing and Contracting Department. Stock items in the inventory records with no goods movement in the last 12 months are identified by Central Stores (by department) and organized into a list. Central Stores attaches this listing to a memo that is sent to each department identified, requiring their review and response for items that may be potentially obsolete within 30 days. Obsolete stock items are to be removed from the Central Stores inventory records and set aside in a timely manner until they are properly disposed.

We noted that obsolete items were properly set aside for disposal at Store 2. However, during our physical inventory count at Store 1, we noted certain obsolete items and damaged goods were mixed in with the general population of inventory stock items and were not properly set aside for disposal in a timely manner.

In addition, we observed various stock items at Store 1 that visibly appeared to be old, outdated, and not usable and should have been identified as obsolete. Based on our observations and discussions with Central Stores Personnel, we recommend organizing a space at Store 1 (separate from other stock items) to accumulate such items until they are properly disposed.

We recommend that Purchasing and Contracting take the appropriate steps to ensure that the timelines set forth in the City's applicable Administrative Regulation and Process Narrative are met. Further, Purchasing and Contracting should work with the client departments and the Office of the City Comptroller to ensure the proper and timely accounting treatment for removing obsolete items.

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

Result: The result of the physical inventory counts for Store 1 and Store 2 were provided to the Department on August 4, 2016.

- 6) 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 4, 2016 to review and finalize the draft report.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the accuracy and completeness of the Central Stores inventory records maintained by the Department. Accordingly, we do not express such an opinion. 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 4, 2016

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Attachment 1

Location	Total Number of Stock Items in Inventory Records¹	Total Inventory Value²	Total Number of Sampled Stock Items³	Total Value of Samples 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
Store 1	1,421	\$ 1,100,149	103	\$ 188,129	71 (30)	\$ 1,972 (2,132)	1.05% -1.13%	\$ 11,532 (12,468)
Store 2	1,662	1,094,538	154	179,914	545 (33)	5,428 (1,234)	3.02% -0.69%	33,022 (7,507)
Totals	3,083	\$ 2,194,687	257	\$ 368,043	553	\$ 4,034	1.10%	\$ 24,055

¹The "Total Number of Stock Items" is as of June 27, 2016, based upon the 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 27, 2016, based upon the 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
Store 1 (B Street)

PROCEDURE 2 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

Material Number (Stock Item)	Material Description	Material Group	Inventory Value (Rounded to Nearest Dollar)	Unit \$ (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory \$ Value Overstated / (Understated) in SAP		
1	22077676	FILTER AIR 24X24X2 PLTD MERV 11	3100	\$ 159	\$ 7	\$ 24	EA	-	24	\$ 158.52	
2	22031815	TIE CABLE NYLON 14.19" T&B #TY528M 100/PK	28000	862	23	38	PK	33	5	113.39	
3	22031816	TIE CABLE NYLON 30" T&B #TY529M 50/PACK	28000	421	32	13	PK	11	2	64.80	
4	22041480	BATTERY - 2800 MAH #4595 NIMH	34500	11,581	32	360	EA	357	3	96.51	
5	22040340	SOAP HANDCLEANER MVP ZEP 32 OZ.	48500	255	7	37	EA	36	1	6.88	
6	22040434	TOWEL TOOL BOX Z400 POPUP BX 8BX PR CASE	48500	1,616	6	283	EA	261	22	125.59	
7	22035137	PAINT SPRAY INVERTED GREEN	63500	845	2	369	EA	368	1	2.29	
8	22014968	BRUSH SHOE SHINE 6.75" MACPHERSON OR =	34500	1,466	7	196	EA	197	(1)	(7.48)	
9	22014533	CAN SAFETY 5GAL TYPE II JUSTRITE #10821	34500	926	33	28	EA	29	(1)	(33.06)	
10	22030265	CUTTER DIAGONAL KLEIN #D2000-28	44500	178	22	8	EA	9	(1)	(22.30)	
11	22077530	BAG TRASH LINER BIG BELLY WAXIE #709334	48500	2,831	37	77	CS	83	(6)	(220.59)	
12	22040322	DETERGENT LAUNDRY LIQUID HD WAXIE 530994	48500	2,444	30	82	EA	96	(14)	(417.27)	
								Overstatement of Units	58	\$	567.98
								Understatement of Units	(23)	\$	(700.70)

PROCEDURE 3 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

Material Number (Stock Item)	Material Description	Material Group	Inventory Value (Rounded to Nearest Dollar)	Unit \$ (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory \$ Value Overstated / (Understated) in SAP		
1	22037736	TATTLETAPE, SECURITY STRIPS B2	61500	\$ 31,375	\$ 189	166	PK	165	1	\$ 189.01	
2	22037089	BOOK COVER SELF-ADHESIVE 13" X 11"	61500	19,749	167	118	PK	113	5	836.85	
3	22038817	FORM PD-851 POLICE LETTERHEAD OFFICAL	61500	7,176	54	133	PK	126	7	377.72	
4	22037121	FORM TR-1505A PARKING CITE COMPUTERIZED	61500	32,843	238	138	PK	144	(6)	(1,427.94)	
5	22035229	PAINT ROLLER HANDLE W/THRD END WOOD	63500	282	3	94	EA	95	(1)	(3.00)	
								Overstatement of Units	13	\$	1,403.58
								Understatement of Units	(7)	\$	(1,430.94)

Attachment 2
Store 2 (Chollas)

PROCEDURE 2 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Material Group	Inventory Value (Rounded to Nearest Dollar)	Unit \$ (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory \$ Value Overstated / (Understated) in SAP
1	22039803	COMPOUND MARKING LINE (GYPSUM) 40LB SACK	15000	\$ 132	\$ 3	39	EA	23	16	\$ 54.28
2	22014670	COVERALL W/ HOOD & FEET 2X	34500	61	2	25	EA	-	25	61.00
3	22014703	GLOVE COTTON WELLS LAMONT Y6502L	34500	8	0	23	EA	12	11	3.92
4	22041482	BATTERY D ALKALINE DURCELL/ENERGIZE 6PK	34500	376	1	477	EA	384	93	73.28
5	22014726	GLOVE PIGSKIN TOP GRAIN XLG 12/PK-120/CS	34500	249	3	84	PR	72	12	35.57
6	22014704	GLOVE SANDPAPER 22-5158 MED 12/PK-120/CS	34500	785	1	552	PR	384	168	238.96
7	22030514	SOCKET SET 3/8"DR 22PCE PROTO #J52136	44500	607	67	9	EA	6	3	202.31
8	22040371	CLEANER BATHROOM DBBC WAXIE 030090 1QT	48500	1,090	3	417	EA	416	1	2.61
9	22077811	SOAP CLEAN TOUCH CITRUS WAXIE 386311	48500	1,518	30	51	EA	30	21	625.00
10	22040387	HANDLE STREET-BROOM SLIP-IN 72"	48500	187	4	48	EA	47	1	3.90
11	22040290	CLEANER SAFETY BLITZ WAXIE 870120	48500	5	3	2	EA	-	2	5.34
12	22040248	BRUSH WIRE WEILER #25150/MILWAUKEE	48500	48	1	38	EA	34	4	5.01
13	22035121	PAINT SPRAY KRYLON YELLOW	63500	312	2	128	EA	90	38	92.51
14	22034912	PAINT BRUSH 1/5" (AGATE)	63500	22	4	5	EA	3	2	8.73
15	22034903	PAINT BRUSH 3" THROW-AWAY	63500	10	0	22	EA	6	16	7.40
16	22034918	PAINT BRUSH 2" (PURDY)	63500	37	5	8	EA	6	2	9.29
17	22043684	BALL FOOT RUBBER JUNIOR VOIT #CF6	65000	97	3	30	EA	29	1	3.24
18	22015943	NUT FLARE 3/8 SHORT NO/LOW LEAD 41S-6	65900	68	1	54	EA	-	54	68.20
19	22019967	PIPE GALVANIZED 2" X 21'FT	65900	962	107	9	EA	6	3	320.68
20	22025951	SADDLE TAP DBL-STRAP 12"X1" PVC	89000	712	178	4	EA	-	4	711.99
21	22022825	ADAPTER HYDRANT 6" X 6" W/GROOVE	89000	467	58	8	EA	6	2	116.64
22	22027672	WIRE WELDING 7100 .045" FLUX CORE	89500	887	5	196	EA	132	64	289.61
23	22039896	STEEL REINFORCING 1/2" X 20' 13.36LBS	15000	35	7	5	EA	6	(1)	(6.90)
24	22031385	COVER PULL-BOX #3-1/2 CAL-TRANS #ES-8	28000	5,399	142	38	EA	39	(1)	(142.09)
25	22030896	HOSE FIRE 1.5 x 50' DJ CPLD ALUM NST	34000	384	96	4	EA	11	(7)	(672.86)
26	22014592	COOLER WATER PORTABLE 3GL RUBBERMAID	34500	1,091	29	38	EA	42	(4)	(114.88)
27	22040998	SAFETY ICE PACK INSTANT-COLD 125/CS	34500	151	0	456	EA	469	(13)	(4.31)
28	22030090	PROBE MIGHTY PROBE MPA 42	44500	527	105	5	EA	7	(2)	(210.60)
29	22040354	DISINFECT HUSKY 814 WAXIE170900 1QT12/CS	48500	409	3	139	EA	141	(2)	(5.88)
30	22015980	BUSHING BRASS 3"X2" NO LEAD LOW LEAD	65900	484	25	19	EA	22	(3)	(76.36)

Overstatement of Units	543	\$	2,939.47
Understatement of Units	(33)	\$	(1,233.87)

Attachment 2
Store 2 (Chollas)

PROCEDURE 3 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Material Group	Inventory Value (Rounded to Nearest Dollar)	Unit \$ (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory \$ Value Overstated / (Understated) in SAP
1	22022861	HYDRANT WET-BARREL 3WAY 6"(2)2-1/2"&(1)4	89000	\$ 27,394	\$ 1,442	19	EA	18	1	\$ 1,441.80
2	22022860	HYDRANT WET-BARREL 2WAY 6" 2-1/2" & 4"	89000	34,539	1,047	33	EA	32	1	1,046.63
									Overstatement of Units	2 \$ 2,488.43
									Understatement of Units	- \$ -

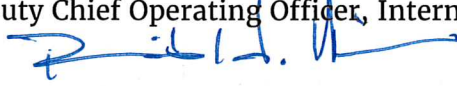


THE CITY OF SAN DIEGO

MEMORANDUM

DATE: October 3, 2016

TO: Honorable Councilmember Scott Sherman and Audit Committee members

FROM: Kristina Peralta, Director, Purchasing & Contracting
via Ronald H. Villa, Deputy Chief Operating Officer, Internal Operations Branch 

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

The purpose of this memorandum is to provide Management's response to the findings and recommendations in the June 30, 2016 report titled *Independent Accountant's Report on Applying Agreed-Upon-Procedures Related to the Central Stores Physical Inventory*. Further, we provide additional information regarding our ongoing efforts to strengthen inventory controls and minimize physical inventory discrepancies in Central Stores stock. Responses to the recommendations are below.

Recommendation 1: "Based on our observations and discussions with Central Stores Personnel, we recommend organizing a space at Store 1 (separate from other stock items) to accumulate such items until they are properly disposed."

Management Response: Agree. The report observes that some items at Store 1 appeared to be old and/or unusable and should have been identified as obsolete. Central Stores staff have sequestered a space within the warehouse to separate unusable inventory from the active stock. The unusable stock has been appropriately accounted for and will be disposed in a manner consistent with applicable City procedures.

Timeframe for Completion: Issues identified in the report have been addressed, and the process will continue on a go-forward basis.

Recommendation 2: "We recommend that Purchasing and Contracting take the appropriate steps to ensure that the timelines set forth in the City's applicable Administrative Regulation and Process Narrative are met. Further, Purchasing and Contracting should work with the

client departments and the Office of the City Comptroller to ensure the proper and timely accounting treatment for removing obsolete items.”

Management Response: Agree. The policy and processes for disposing of obsolete inventory are set forth in Administrative Regulation (A.R.) 35.50, and specifically described in Process Narrative PN-0253. In general, A.R. 35.50 calls for obsolete and/or surplus stock to be disposed of as promptly as practical. The A.R. also notes that any financial loss resulting from the disposition of stock items carried primarily or exclusively for a single division or department will be absorbed by the department or division concerned. Finally, PN-0253 provides detail on the accounting processes for charging off obsolete inventory to the departments. Going forward, Purchasing & Contracting will ensure that the obsolete inventory regulations and processes are followed more systematically through improved communication with client departments and effectuating the process earlier in the fiscal year to allow more time for review and timely accounting.

Timeframe for Completion: To be completed annually; will commence process late in the fourth quarter of each fiscal year and complete by the end of each fiscal year.

In addition to the recommendations noted above, the report provides results of the physical inventory at both Central Stores locations. In both locations, the report identifies certain discrepancies between physical counts and the recorded inventory. We find any level of inventory discrepancy to be unacceptable and have taken steps to ensure accurate inventories at both locations. Specifically, we have taken the following steps:

1. Upon receipt of the independent auditor’s results of the physical inventory, we reviewed each of the discrepancies noted to determine possible causes. In some cases, the discrepancies resulted because of recordkeeping errors. For example, some items were disposed of, but not taken out of the records. In other cases, the discrepancies were the result of data-entry errors. For example, some items were recorded in the incorrect unit of measurement. To the maximum extent possible, we have addressed the discrepancies noted in the report and have taken steps to ensure more accurate record keeping and data-entry. Much of this involved reassessing existing practices, fine-tuning those practices, and having supervisors emphasize the correct processes in training new and existing employees.
2. We have established more consistent rolling inventory practices. Specifically, staff have been directed to conduct inventory on segments of the stock each day. Discrepancies are to be reported, assessed, and corrected in the same day.
3. We have enhanced physical controls at both stores. For example, staff from client departments are required to have a Central Stores staff member with them when retrieving items from the warehouse. Further, we have established a double-check, segregation of duties process for checking stock in and out the warehouse to ensure all departing or returning items are accurately accounted for in the inventory system.
4. We have begun the process of planning to consolidate the two Central Stores facilities into one location. The goal of the consolidation is to reduce facilities operating expenses and improve the efficiency of the warehouse. Importantly, consolidation will enable us to eliminate redundancies in inventory that currently exist between the two warehouse locations, which will help eliminate discrepancies.

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Honorable Councilmember Sherman and Audit Committee Members
October 3, 2016

We'd like to thank the independent auditor's team and the Office of the City Auditor for allowing us to comment on the report. The team was very professional and thorough, and provided a number of valuable observations that were greatly appreciated.



Kristina Peralta
Director of Purchasing and Contracting Department

KP/le

cc: Stacey LoMedico, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Rolando Charvel, City Comptroller, Office of the City Comptroller
Matthew Helm, Deputy Director, Purchasing and Contracting
Thomas Sawade, Stores Operations Supervisor, Purchasing and Contracting