



THE CITY OF SAN DIEGO AUDIT REPORT

Monday, December 10, 2007

Tammy Rimes
Acting Director Purchasing and Contracting

SUBJECT: CENTRAL STORES INVENTORY AUDIT

PERIOD: FISCAL YEAR 2007

AUDIT PURPOSE:

- To confirm valuation of Central Stores inventory.
- To evaluate Storeroom internal controls.

METHODOLOGY:

- Reviewed procedures for issues, receipts and transfers of stock, and evaluated governing internal controls.
- Stratified the inventory by total inventory value at all storerooms. Selected a random sample of inventory from seven (7) storerooms based on value: 1% of items with a value less than \$1,000, 10% of items valued between \$1,000 and \$5,000 and 100% of items with a value greater than \$5,000. Compared quantity per physical inventory count to the automated inventory system (FleetFocus).
- Analyzed year to date adjustments, suspense items and obsolete inventory for compliance with City of San Diego regulations (i.e. Municipal Code and Administrative Regulations).
- Determined if prior audit recommendations were implemented.

SUMMARY:

We conducted our audit in accordance with Generally Accepted Government Auditing Standards. We performed a physical count of **172** stock items from Central Stores inventory, with a total value of **\$800,465**, and found 51 of those items (29.7%) were over or (short). The net value of over/(short) items is **(\$10,418)** or **(1.3%)** of the total value of the inventory counted. It should be noted that a majority of this discrepancy was due to over/(short) items at departmental storerooms. Supervising staff of those departmental storerooms are receiving a copy of this report to notify them of the results of our audit.



Although improvements could be made to increase the accuracy of the inventory maintained by some storerooms, the overall net value of items found to be over/(short) is immaterial compared to the value of the items counted. Below is a table summarizing the results of the Fiscal Year 2007 inventory count, and a summary by storeroom (Exhibit A) is attached.

DESCRIPTION	FY 2007
Value of Central Stores Inventory (As of 6/13/07) [1]	\$2,047,383
Total Number of Items in Central Stores Inventory [1]	3,902
Number of Items Counted	172
Number of Items Over and Short (Gross)	51
Percentage of Items Over and Short (Gross)	29.7%
Value of Items Counted	\$800,465
Value of Items Over and Short (Gross)	\$16,979
Value of Items Over and (Short) – Net	(\$10,418)
Percentage of Value Over and (Short) – Net	(1.3%)

Footnote:

[1] Excludes 319 items valued at \$30,042 that was being transferred to Fleet Service Division.

CENTRAL STORES RESPONSE:

Central Stores will continue to strengthen internal controls to increase inventory accuracy. It is important to note that Central Stores under Purchasing & Contracting Department (Store 1 Central Operations) and Store 2 (Chollas Operations) reported an inventory accuracy rate of 85% with the dollar accuracy rate of 99.7%. In comparison, the five (5) Departmental stores (Store 42 and 43 Fire, Store 75 Police, Store 77 Library and Store 88 Equipment Division), reported an accuracy rate of 52% with the dollar accuracy rate of 94.2%. Central Stores will work with management at the Departments of these Storerooms to review their internal processes/controls to assist with bringing up their inventory accuracy measures to within the set standards. Central Stores management will also open discussions with those Departments which have Departmental Storerooms to explore the possibility to further streamline storeroom functions by way of consolidating these operations into the Central Stores staffed and operated warehouses. Stores 43 and 88 are no longer part of the Central Stores system as of July of FY08, they have been merged into the General Services Fleet Management Division.

FINDINGS AND RECOMMENDATIONS:

Finding 1: The Storekeeper's procedures for processing stores requisitions should be improved to strengthen internal controls over the issuance of inventory items.

We tested 71 Stores Requisition authorizations, and found 44 out of 71 (62%) were lacking in adequate segregation of duties regarding the issuance of inventory items. Of the 71 requisitions reviewed, 5 or 7% were missing an "Authorized By" signature, 19 or 27% were missing a "Received by" signature, 4 or 6% were missing both the "Authorized By" and "Received By" signatures, and 16 or 23% had the same signature for both "Authorized By" and "Received By". A memo will be sent to Department Director's (see memo attached) recommending they review their inventory procurement procedures to ensure adequate compensating controls over purchases are in place.

In addition, 42 of the requisitions had not yet been entered into FleetFocus. We reviewed these requisitions for timeliness of processing and found that 9 or 21% had a date that was older than 1 week. When stores requisitions are not processed in a timely manner, there is a risk of loss of the requisition resulting in inaccurate inventory and accounting.

Recommendations:

- A. Ensure each requisition form completed for all stock issuances has a "Received By" and "Authorized By" signature properly recorded on the form.**
- B. Ensure you maintain a file of authorization memos for those departments that permit the same individual to authorize the requisition and receive the goods.**
- C. Ensure all requisitions are processed daily.**

CENTRAL STORES RESPONSE:

- A. All Central Stores Requisitions require an "Authorized and Received" by Signature. This procedure will be reviewed with all Storeroom staff in both Central Stores as well as the Departmental Stores to ensure full compliance.*
- B. We will meet with our customer departments within the next sixty (60) days to discuss this recommendation.*

- C. *Requisitions are posted/processed every day as long as the provided accounting information is accurate. A time stamp will be placed at both Store 1 (Central Operations) and Store 2 (Chollas) to stamp the Order Requisitions when they are provided to Central Stores to measure same day processing. It is common for requisitions to sit in a City crew's possession for a few days after the requisition is approved making the date on the requisition old and non-measurable. City crews will be encouraged to submit requisitions in a more timely manner as well.*

Finding 2: Internal control weaknesses were identified in the procedures for issuing stock to Non-City Agencies.

Central Stores occasionally issues stock to Non-City Agencies. Agencies that purchase stock from Central Stores are invoiced bi-monthly. During our review, we noted that stock issues to 2 Non-City Agencies on 6/27/07 from the Police Department Storeroom, were not invoiced as of 8/16/07, indicating that Agencies are not invoiced in a timely manner. In addition, we noted the following internal control weaknesses:

- There is currently no written policy regarding stock issues to Non-City Agencies.
- There are currently no limitations on the type of stock that is issued to Non-City Agencies. Stock items issued ranged from forms to batteries.
- There are no procedures in place to verify that the employees from the Non-City Agencies are authorized by the outside Agencies to purchase stock from City storerooms (i.e. Authorized employee listings).

Recommendations:

- A. **Create a written policy for stock issued to Non-City Agencies. The policy should consider limitations on the type of stock issued and should include adequate controls to ensure purchases are authorized and all City costs are recouped. Ensure all departmental storerooms adopt this policy or submit a copy of their policy to Central Stores.**
- B. **Ensure the surcharge percentage billed to Non-City Agencies is sufficient to recoup all of overhead costs incurred by the City to invoice and collect funds from outside Agencies for stock purchases.**

CENTRAL STORES RESPONSE:

Two Non-City Agencies were issued materials on June 27, 2007 from the Police Department Storeroom (Store 75) and were not invoiced as of August 16, 2007. These were found to be un-keyed requisitions that were keyed in after July, 2007. This meant that these transactions did not appear on the bi-monthly report for inventory sales to

Non-City Agencies for the period May 1, 2007 through June 30, 2007, as required. All other Non-City Agencies making purchases during this period were invoiced in a timely manner. This issue will be addressed with the Police Department's storeroom team as part of Finding No. 1, un-keyed requisitions.

Central Stores will create a written policy for stock issues to Non-City Agencies. This policy will outline any limitations on the type of stock that can be issued and will include the proper controls to ensure that all purchases are properly authorized by the agency. This policy will include any sales from departmental storerooms. Central Stores will also conduct a study of our current surcharge percentage billed to Non-City Agencies to determine if it sufficiently covers all overhead costs incurred to invoice and collect funds from outside agencies for stock purchases. Both the written policy and the surcharge study will be complete by December 31, 2007.

Finding 3: Pricing discrepancies were found for 3 items in the FleetFocus system, and significant differences were found in the price charged for the same stock items at various storerooms.

The price shown in the FleetFocus system is calculated by the system and is based on a weighted average of the number of units purchased and the unit price paid by Central Stores at the time of purchase. We noted 3 items with significant pricing differences between the FleetFocus system and the price paid by Central Stores at the time of purchase (price shown on Purchase Order). Using a weighted average calculation, these differences ranged from 14% to 72% for these items. Per Central Stores staff, no explanation could be provided for the cause of the pricing discrepancies.

Additionally, price discrepancies were noted within the FleetFocus system for the same stock items at different storerooms. There were several items in inventory with a price difference between storerooms greater than \$10, and 18 of them had a percentage difference greater than 25%. Per Central Stores staff, these pricing discrepancies are due to: different units of measure sold at different storerooms for 4 of the items, different brand names carried at different storerooms for 13 of the items, and changes in market value for 1 item. A complete listing of these items is included in Exhibit B.

Recommendations:

- A. Require Central Stores staff to implement daily analytical procedures to identify and correct price discrepancies within the FleetFocus system and continue to work with the FleetFocus vendor to ensure pricing accuracy.**

- B. For items with pricing discrepancies due to unit of measure or differing brand name, require Central Stores staff to include descriptive notations in the FleetFocus system.**

CENTRAL STORES RESPONSE:

- A. Central Stores is scheduled to be in phase 1 of the City's implementation of SAP in the summer of FY09. Because of the delays in identifying the cause of the Unit Price Problem with the current FleetFocus vendor, Central Stores will create a daily procedure at each storeroom to ensure unit prices are accurate and document price variances of more than 10% after each purchase order receipt.*
- B. Unit of Measures in FleetFocus will be reviewed and updated at the location (warehouse) level to outline the selling unit of measure within the next sixty (60) days.*
- C. The introduction of the City's Procurement Card to procure inventory introduced a non-centralized procurement effort is resulting in different brand names of items being purchased other than the description in FleetFocus displays. This is causing like descriptions (same stores stock numbers) in FleetFocus to have a disparity in unit prices. System limits set forth in FleetFocus limit item descriptions at the location (warehouse) level. All item descriptions are captured at the item master level and if changed will change the description for all warehouses. A review of creating a centralized procurement effort for all Stores Stock will be done in the next 60 days which will ensure maximum efficiencies in the procurement process and similarity in stock items at all Storeroom locations.*

Finding 4: Central Stores did not fully comply with Administrative Regulation (AR) 35.50 regarding obsolete inventory.

AR 35.50 requires Central Stores to annually circulate to the principal using departments and divisions, a list of special stock items carried which are believed to be obsolete. The using department/division is to review the list and in writing, within 30 days, request the items they wish to continue to be stocked. Central Stores is to declare obsolete all the items not justified by the department/division within the 30 day time period.

Per the "Obsolete Items by Store Number – as of 6/30/07" report provided by Central Stores, 171 items are stocked with a last issue date prior to 6/30/06. The total value of these items is \$66,263.00. For FY2007, Central Stores circulated a list of 38 items believed to be obsolete to only one department.

Recommendation:

In compliance with AR 35.50, circulate to the principal using departments and divisions, a list of the remaining 133 items with a last issue date prior to 6/30/06 to determine if the departments wish for these items to remain as stock items. Require the departments to respond within the 30 day time period. Upon receipt of the response, declare obsolete all the items not justified by the department.

CENTRAL STORES RESPONSE:

Central Stores will complete processing the memorandums to departments for the remaining 133 (0.4% of the items carried in active inventory) possible obsolete items before January 1, 2008. Upon receipt of the response, appropriate action will be taken to declare the obsolescence or justification to remain in inventory.

Finding 5: The Central Stores' Policy and Procedures Manual has not been updated subsequent to the implementation of FleetFocus System.

As we reported in prior audits, Central Stores should keep the department's manual current as it serves as a source of reference for staff as well as a tool to evaluate staff performance. The manual should be updated to reflect the changes resulting from the implementation of the FleetFocus System and recent separation of the Fleet Service Division from Central Stores.

Recommendation:

Update the Central Stores' Policy and Procedure Manual.

CENTRAL STORES RESPONSE:

The Central Stores Procedure Manual will be reviewed and updated this Fiscal Year where applicable. With the implementation of SAP in the summer of FY09, several business processes are expected to change and the Policy Manual will be updated as the implementation proceeds.

I would like to thank Tammy Rimes and her staff for the assistance we received during the course of this audit. If you have any questions, please contact me.



Kyle Elser
Internal Audit Manager

Attachments: 1. Exhibit A
2. Exhibit B
3. Memorandum to Department Directors

cc Honorable Audit Committee Members
Jay Goldstone, Chief Operating Officer / Acting Chief Financial Officer
Eduardo Luna, Internal Auditor
Stanley Keller, Independent Oversight Monitor
Andrea Tevlin, IBA
Jeff Jungers, Stores Operations Supervisor
Steve Fragoso, Supervising Storekeeper
Ron Villa, Fiscal Operations Manager, San Diego Police Department
Doug Murphy, Fleet Parts Buyer
Jeff Frazier, Deputy Fire Chief
Dave Beers, Fleet Parts Buyer
John Alley, Deputy Director, General Services
Anna Tatar, Library Director

Exhibit A

**Central Stores Inventory Audit FY 2007
Summary of Physical Inventory Counts
Conducted June 25-29, 2007**

Store Number	Store Location	No. of Items Counted	Value of Items Counted	No. of Items in Storeroom	Percentage of Items Counted	Value of Items in Storeroom	Percentage of Value Counted
1	Central Stores, Central Operations (20th & B)	36	\$ 214,484.60	980	3.67%	\$ 581,457.31	36.89%
2	Central Stores, Chollas Operations	61	\$ 438,170.56	1,208	5.05%	\$ 913,459.19	47.97%
42	Fire & Life Safety	15	\$ 41,193.30	330	4.55%	\$ 181,127.65	22.74%
43	Fire & Life Safety, Repair Facility	15	\$ 20,286.24	611	2.45%	\$ 83,484.51	24.30%
75	Police Headquarters	15	\$ 68,319.13	440	3.41%	\$ 234,828.13	29.09%
77	Library, Central	15	\$ 13,825.29	119	12.61%	\$ 37,559.01	36.81%
88	Equipment Division, Chollas	15	\$ 4,185.62	214	7.01%	\$ 15,467.51	27.06%
TOTAL		172	\$ 800,464.74	3,902	4.41%	\$ 2,047,383.31	39.10%

Store Number	No. of Items Over	Value of Items Over	No. of Items Short	Value of Items Short	Total Absolute No. of Items Over/Short	Percentage Of Items Over/Short	Net Value of Items Over/(Short)	Net % Value Over/(Short)
1	1	\$ 54.56	0	\$ -	1	2.78%	\$ 54.56	0.03%
2	5	\$ 234.58	9	\$ (2,071.68)	14	22.95%	\$ (1,837.10)	-0.42%
42	5	\$ 2,653.76	7	\$ (3,834.29)	12	80.00%	\$ (1,180.53)	-2.87%
43	4	\$ 175.47	7	\$ (7,467.34)	11	73.33%	\$ (7,291.87)	-35.94%
75	3	\$ 152.50	6	\$ (324.24)	9	60.00%	\$ (171.74)	-0.25%
77	2	\$ 0.26	1	\$ (1.08)	3	20.00%	\$ (0.82)	-0.01%
88	1	\$ 9.04	0	\$ -	1	6.67%	\$ 9.04	0.22%
TOTAL	21	\$ 3,280.17	30	\$ (13,698.63)	51	29.65%	\$ (10,418.46)	-1.30%

Central Stores Inventory Audit FY 2007
Items with a Price Difference Greater than \$10 and 25%

Footnote	Stock No	DESCRIPTION	Storeroom	Unit Price	% Diff	\$ Diff
	018028	KIT - END MIDLAND 107798 *PA199	89	\$ 21.10		
A	018028	KIT - END MIDLAND 107798 *PA199	88	\$ 22.14	5%	1.04
	018028	KIT - END MIDLAND 107798 *PA199	43	\$ 31.43	42%	9.29
	037531	HOSE GREASE-GUN 12" LINCOLN #8 *PA223	2	\$ 5.33		
A	037531	HOSE GREASE-GUN 12" LINCOLN #8 *PA223	43	\$ 7.22	35%	1.89
	037531	HOSE GREASE-GUN 12" LINCOLN #8 *PA223	89	\$ 21.01	191%	13.79
	177140	STEPLADDER FIBERGLASS 6FT NON-CONDUCTIVE GORILLA A-124-000	42	\$ 56.71		
A	177140	STEPLADDER FIBERGLASS 6FT NON-CONDUCTIVE GORILLA A-124-000	2	\$ 99.13	75%	42.42
	410977	DRILL SET 21PC CRAFTSMAN 9-64085 WESCO 71-4994-64085	2	\$ 55.32		
A	410977	DRILL SET 21PC CRAFTSMAN 9-64085 WESCO 71-4994-64085	1	\$ 79.11	43%	23.79
	412884	HAMMER SLEDGE 8LB W/HANDLE	1	\$ 13.84		
A	412884	HAMMER SLEDGE 8LB W/HANDLE	2	\$ 26.14	89%	12.30
	414839	PITCHFORK 6-TINE	1	\$ 30.20		
A	414839	PITCHFORK 6-TINE	2	\$ 47.00	56%	16.80
	417259	SOCKET SET 1/2" DRIVE	2	\$ 104.05		
A	417259	SOCKET SET 1/2" DRIVE	1	\$ 256.21	146%	152.16
	417261	SOCKET SET 3/8" DRIVE	2	\$ 58.42		
A	417261	SOCKET SET 3/8" DRIVE	1	\$ 116.19	99%	57.77
	418528	WRENCH HEX-KEY 13-PIECE ARMSTR	2	\$ 3.18		
A	418528	WRENCH HEX-KEY 13-PIECE ARMSTR	1	\$ 21.81	586%	18.63
	418673	WRENCH PIPE 18	1	\$ 17.77		
A	418673	WRENCH PIPE 18	2	\$ 57.95	226%	40.18
	428166	HYD.WRENCH-ADJ.-NEW STYLE	42	\$ 23.12		
A	428166	HYD.WRENCH-ADJ.-NEW STYLE	2	\$ 38.13	65%	15.01
	442152	WIRE #12 THHN SOLID GREEN	1	\$ 67.06		
A	442152	WIRE #12 THHN SOLID GREEN	2	\$ 87.90	31%	20.84
	442154	WIRE #12 THHN STRANDED GREEN WESCO 78-0100-22940	2	\$ 52.84		
A	442154	WIRE #12 THHN STRANDED GREEN WESCO 78-0100-22940	1	\$ 68.86	30%	16.02
	552462	OIL MOTOR 40WT	2	\$ 234.69		
B	552462	OIL MOTOR 40WT	43	\$ 428.73	83%	194.04
	593525	FORM AC-468 DIRECT PAYMENT REQ	77	\$ 0.39		
C	593525	FORM AC-468 DIRECT PAYMENT REQ	75	\$ 2.93	651%	2.54
	593525	FORM AC-468 DIRECT PAYMENT REQ	1	\$ 20.80	610%	17.87
	593682	FORM PW-999B BLDG DIV WORK REQ	77	\$ 0.16		
C	593682	FORM PW-999B BLDG DIV WORK REQ	1	\$ 10.39	6394%	10.23
	594036	FORM RM-1531A OCCUPATIONAL INJ	75	\$ 1.28		
C	594036	FORM RM-1531A OCCUPATIONAL INJ	1	\$ 17.42	1261%	16.14
	652088	PAD - UNIVERSAL ABSORBENT 17" X 19	2	\$ 46.72		
C	652088	PAD - UNIVERSAL ABSORBENT 17" X 19	89	\$ 59.27	27%	12.55

Footnotes:

- A Per Central Stores staff, pricing discrepancy due to different storerooms carrying different brand names.
 B Per Central Stores staff, pricing discrepancy due to changes in market value.
 C Per Central Stores staff, pricing discrepancy due to different storerooms carrying different units of measure.



THE CITY OF SAN DIEGO
MAYOR JERRY SANDERS

M E M O R A N D U M

DATE: December 10, 2007

TO: Department Directors

FROM: Kyle Elser, Internal Audit Manager

A handwritten signature in black ink that reads "Kyle Elser".

SUBJECT: Central Stores Inventory Audit

Internal Audit has completed a review of Central Stores Inventory, which included a test of 71 Store Requisition authorizations from various City Departments. We found 44 out of 71 (62%) were lacking adequate segregation of duties regarding the issuance of inventory items as follows:

- 5 out of 71 (7%) had a blank "Authorized By" box.
- 19 out of 71 (27%) had a blank "Received By" box.
- 4 out of 71 (6%) had blank "Received By" and "Authorized By" boxes.
- 16 out of 71 (23%) of the requisitions were "Authorized By" and "Received By" the same individual.

Although we did not review the entire requisition process in every City Department, these findings reveal a control weakness that increases the risk of misappropriation of City assets. We recommend Departments review their inventory procurement procedures for the following recommended compensating controls over purchases to reduce this risk:

1. Prior authorization and approval

- *The appropriate supervisors should approve all purchases.*

2. Security of records

- *Access to blank requisition forms should be strictly controlled.*

3. Segregation of incompatible duties

- *The receipt of goods should be confirmed in writing by an individual other than the one who authorized the requisition.*

4. Supervisory verification

- *Supervisors, or a designated independent employee, should receive the goldenrod copies of requisitions from the storerooms or the monthly purchase report, and review them for reasonableness and/or proper authorization.*
- *The review process should be documented with initials and dates, and proof of the verification process should be retained for at least three years.*

In addition, we conducted a cursory review of items purchased on Citywide Blanket Purchase Orders (Open POs). These purchase orders are governed by Administrative Regulation 35.15, which states that items carried by Central Stores are not to be purchased on Open POs. Although we did not find specific instances of non compliance with AR 35.15, we recommend all City Departments, who purchase items via an Open PO, work with Central Stores staff to ensure that AR 35.15 is complied with. In addition, for items continually purchased on Open POs that are not carried by Central Stores, departments should analyze these items to determine if it would be cost beneficial to request Central Stores to stock these items.

All departments should be proactive in ensuring appropriate controls over Central Stores purchases are in place, working as intended, and continually monitored. This is another reminder that it is management's responsibility to establish, maintain, and review a sound internal control structure within the City of San Diego. The Central Stores Inventory Audit will be performed annually, and various City Departments will be included in sampling each year.

If you have any questions, or would like additional information, please call me at 533-5281, or E-mail me at KElser@sanidiego.gov.