BERNALILLO COUNTY
NEW MEXICO

Receiving and Issuing

Internal Audit

December 2012

Bernalillo County Internal Audit
Receiving and Issuing

Executive Summary

SUMMARY OF PROCEDURES

REDW performed an internal audit over Bernalillo County's receiving and issuing processes. We analyzed the adequacy and reasonableness of internal controls for receiving, issuing and storing supplies, materials, and equipment at various departments, the Public Works warehouse and the Metropolitan Detention Center (MDC) warehouse.

The procedures performed included:

- Obtaining an understanding of the County procedures through reading relevant Administrative Instructions, County Purchasing and Contracting Guidelines, and County P-card Guidelines;

- Obtaining an understanding of the County Purchasing Department procedures through interviewing various Public Works warehouse, MDC warehouse, Accounting and Purchasing Department Personnel;

- Testing a sample of county-wide purchases made during fiscal year 2012 for items that were more susceptible to theft to determine if the items were at the County and that controls were in place to mitigate the risk of theft;

- Testing a sample of inventory purchases received in the MDC and Public Works warehouses in September and October 2012 to determine that items were properly matched to the purchase order and received into inventory;

- Analyzing inventory, supply, and material adjustments made in fiscal year 2012 for the MDC and Public Works warehouses to determine if significant or unusual adjustment activity had occurred;

- Visiting the MDC and Public Works warehouses to determine if proper physical security controls were in place;

- Testing a sample of employees with SAP/SRM user access as of December 2012 to determine that authority levels matched the approved Workflow Authority Form and that roles were properly segregated between purchasing and receiving functions;

- Testing a sample of county-wide purchases from October 2012 to determine that invoices were not paid prior to items being received and invoices were properly matched with the purchase order and items received;

- Testing a sample of inventory items issued from the MDC and Public Works warehouses in October 2012 to determine if documentation was on file to support the goods issued and included the signature from the personnel receiving the items; and,

- Testing a sample of inventory items on hand at the MDC and Public Works warehouses on November 28, 2012 and November 29, 2012, respectively, to determine if inventory counts in the system properly reconciled to the physical counts.

SUMMARY OF OBSERVATIONS AND RECOMMENDATIONS

We found areas during the course of the audit where controls were functioning properly and established procedures were followed. All inventory controls and processes tested at the MDC inventory warehouse were operating efficiently as it related to physical access, receiving and issuing goods and reconciliation between physical and system counts. All purchases tested were verified for items and quantity ordered prior to payments being processed.

Significant medium risk observations are presented below:

- **Public Works Inventory Issuance Accuracy**—The Public Works fleet inventory had user input discrepancies caused by several similar parts that were miscoded. Personnel should ensure the item issued matches the item updated in the system.

- **Auto Parts Inventory Count Discrepancies**—The Public Works warehouse, specifically as it related to fleet inventory management, had inventory count discrepancies. Physical count to system count reconciliations should include supporting documentation to show that significant discrepancies are investigated in order to assure proper accounting and help prevent theft.

- **System User Roles Documentation**—The Workflow Authority Forms used to document system user roles are not maintained in a comprehensive format by department. System user roles should agree to a properly updated and approved workflow authority form to support the authority levels in the system. A process should be implemented to ensure that there is a comprehensive Workflow Authority Form for the entire department that lists all employees and their current system roles.

- **Centralized Receiving and Low Value Assets**—The County currently does not have clear guidelines indicating which departments are required to track low value assets. The County should consider centralizing this process for departments with a significant amount of low value assets.

The lower risk observations are included in the attached detailed report.

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Further detail of our purpose, objectives, scope, procedures, observations, and recommendations are included in the internal audit report. In that report, management describes the corrective action taken for each observation.

We received excellent cooperation and assistance from the various departments during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico
January 25, 2013

Bernalillo County Internal Audit
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Report

INTRODUCTION

We performed the internal audit services described below solely to assist Bernalillo County in evaluating the internal controls and safeguards in place surrounding the receiving, issuing, and storing of supplies, materials, and equipment. Our services were conducted in accordance with the Consulting Standards issued by the American Institute of Certified Public Accountants, Generally Accepted Government Auditing Standards, and the terms of our contract agreement for internal audit services. Since our procedures were applied to samples of transactions and processes, it is possible that significant issues related to the areas tested may not have been identified.

An entrance conference was held on November 30, 2012, at which time most items needed for the audit were requested. Fieldwork began the week of November 26, 2012. An exit conference was held on January 25, 2012, and final management responses were received on February 8, 2013.

Although we have included management's responses in our report, we do not take responsibility for the sufficiency of these responses or the effective implementation of any corrective action.

PURPOSE AND OBJECTIVES

Our internal audit focused on the assessment and testing of internal controls for receiving, issuing and storing supplies, materials, and equipment at various departments, the Public Works warehouse, and the MDC warehouse. In fiscal year 2012 the County expended approximately $7,000,000 in supplies, materials and equipment.

SCOPE AND PROCEDURES PERFORMED

In order to gain an understanding of the processes and operations surrounding receiving and issuing, we interviewed the following personnel:

- Lisa Sedillo-White, Purchasing Director

- Adrienne Candelaria, Special Projects Coordinator for the Purchasing Department

- Randy Baca, Inventory Control Administrator for the warehouses at Public Works and MDC

- Dwight Coleman, Fleet Administrator

- Ben Garcia, Inventory Control Coordinator at the MDC warehouse

- Anna Schmidt, Inventory Control Tech at the MDC warehouse

- Mary Trujillo, Inventory Control Tech at the MDC warehouse

- John Montano, Inventory Control Tech at the Public Works warehouse

- Lawrence Salazar, Inventory Control Tech at the Public Works warehouse

- Nick Bryant, Inventory Control Tech at the Public Works warehouse

- Amy Childers, Financial Projects Coordinator in the Accounts Payable department

In order to understand the receiving and issuing process policies and procedures we read relevant portions of:

- Purchasing Inventory Management Section Sign Shop process;

- Facilities Material Inventory and Control;

- Fleet/Facilities Department Inventory Management Section process;

- Work Instructions for the MDC warehouse related to creating and deleting reservations and pick lists for goods, issuing goods, and Materials Requirements Planning (MRP) planned orders;

- Inventory Warehouse Stock Replenishment process;

- Year-End Inventory Closeout 2012 process;

- P-card Guidelines;

- Purchasing and Contracting Guidelines;

- Administrative Instruction No. PD 01 – Purchasing;

- Administrative Instruction No. BD 01 – Accounts Payable;

- Administrative Instruction No. AD 05 – Consumable and NonConsumable Inventory; and,

- Administrative Instruction No. AD 04 – Fixed Assets;

We performed the following testwork:

General Receiving: We obtained a listing of all county-wide purchases for supplies, inventory, and materials in fiscal year 2012. We analyzed the data for items that were unusual based on the frequency of the purchase, type of purchase, and items that appeared to be more susceptible to theft. We selected a sample of 11 departments that resulted in 64 items and tested that:

- The purchase appeared reasonable for departmental use;

- The item was properly coded in the system and was included on the low value listing; and

- The receiving and issuing process was followed.

From the sample, we selected 12 items and performed site visits to observe the item at the department and determine if the item was properly secured, if applicable.

Warehouse Receiving: We obtained a listing of all inventory received into MDC and the Public Works warehouse for auto parts and signage for the month of October 2012 and for Public Works custodial items for the month of September 2012. We selected a sample (based on 90% confidence level (CL) and 10% tolerable deviation (TD)) of 51 items and tested receiving documents for evidence the items were properly matched to the PO and signed off by authorized personnel signifying their approval that items were received.

Adjustments: We obtained a listing of all inventory, supply, and material adjustments made in fiscal year 2012 for the MDC and Public Works inventory warehouses. We analyzed the adjustment reports to determine which areas had significant or unusual adjustments, and for those areas identified we examined the documentation to determine if proper support and approval were obtained and variances were investigated. We also analyzed the auto parts data for unusual activity including the employee making the change and significant variances.

Physical Access: We visited and observed physical security controls in place at the MDC and Public Works warehouses. We tested for security cameras with recording devices, locked storage areas, badge access, and alarmed entry.

System Access Controls: We obtained a listing of all departmental SAP/SRM system access to the purchasing system as of December 3, 2012. We selected a sample (based on a 95% CL and 5% TD) of 52 employees and tested the authority levels on the listing agreed to the approved workflow authority forms. We further tested that the employee assigned to make the purchase was separate from the person assigned to receive the purchase.

Payment Processing: We obtained a listing of all county-wide purchases from the month of October 2012 and selected a sample of 10. For each purchase we tested that the invoice was not paid until the items were received, the invoice and/or receiving documents agreed to the PO, and the purchase was properly approved prior to the payment being made.

Issuing: We gained an understanding of the process for issuing items to personnel from the MDC and Public Works warehouses. We obtained a listing of all items issued during the month of October 2012 for the MDC and for Public Works signage, automotive and custodial inventories and selected a sample (based on 90% CL and 10% TD) of 77 items. We tested that each item was properly depleted in the system, signed by the employee issuing the items and signed by the employee receiving the items.

Inventory Counts: We obtained a listing of current inventory at the MDC warehouse on November 28, 2012, and the Public Works warehouse on November 29, 2012, and selected 22 items from each to test that the physical count agreed to the system.

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

We identified the following weaknesses relating to the Bernalillo County receiving and issuing processes:

1) *Public Works Inventory Issuance Accuracy*

As items are taken out of inventory, they should be updated in the system to reflect current quantities on hand. One of 22 items tested was not properly depleted in the M4 system. Two of 22 items were miscoded when updated in the M4 system; therefore, the physical count indicated a shortage for one item and an overage for the item that was miscoded.

Maintaining accurate system inventory counts will help ensure that financial information related to inventory is reported accurately and improve the County's ability to detect theft.

Risk level—Moderate

Recommendation

Personnel should ensure the item issued agrees to the item updated in the system. If possible, UPC codes should be utilized to identify items. This will reduce errors and make the physical inventory counts quicker and more accurate. Alternatively a log could be kept for the auto parts issued to ensure that all requests are properly entered into M4. All personnel with M4 access should have a master list of inventory items with descriptions and codes to help code the correct items to the work orders.

Management Response

Management agrees with the finding and recommendation. A master list of inventory items with a description and codes will be created and given to all Inventory Staff to ensure that all requests are properly entered into M4 accurately by the end of March 2013. In addition, the Purchasing Department currently has a contract with PMC Solutions, Inc., for the documentation of Procurement processes, to include Inventory Management. All Inventory business processes implemented will be documented and all applicable staff will be trained.

2) *Auto Parts Inventory Count Discrepancies*

Although we inspected count, recount sheets and a memo describing general reasons for discrepancies in the year-end inventory counts, we found there was no investigation of why discrepancies occurred. During FY 2012 there were a total of 315 adjustments. After inventory counts are completed, variances should be investigated and documented. Investigating variances will help reduce errors and identify theft in a timely manner.

Risk level—Moderate

Recommendation

Significant count differences indicate that processes are not operating effectively and should be evaluated to prevent future discrepancies from occurring. There should be a threshold for evaluations and documentation should be retained. This would allow for someone to analyze the data and identify items that are often stolen or misplaced and implement controls to mitigate losses.

The process at the MDC warehouse is functioning well and should be implemented at other inventory warehouses.

Management Response

Management agrees with the finding and recommendation. This finding, as with Finding No. 2 above involves the County's Fleet Management System (M4), which is outdated and in need of replacement. The County is planning to upgrade to M5 in the near future, which will provide a financial interface to SAP and provide accurate "on-shelf" counts of material. A formal process for investigating discrepancies will be implemented, which will include establishment of a variance threshold along with the creation of a form for reporting discrepancies, findings, and resolutions which will require management signature. This process should be implemented by the end of March 2013. The forms will be filed in the Inventory Section of the Purchasing Department. In addition, the Purchasing Department has contracted with PMC Solutions, Inc. to assist in the documentation of overall Procurement processes, including Inventory Control Management, of which inventory variances and corresponding adjustments are a component. The documentation of Inventory Control processes should be completed by end of April 2013. Inventory staff will be trained on all business processes.

3) *System User Roles Documentation*

System user roles are documented on approved workflow authority forms. There are several versions of these forms maintained and when a new form is completed it does not supersede the previous form. There is not a comprehensive listing of roles by department; therefore, in order to determine if there are inconsistencies, all previously submitted forms must be reviewed which causes inefficiencies and makes tracking difficult.

Risk level—Moderate

Recommendation

Each department should have only one current workflow authority form that lists all employees and their system user roles. When roles are changed, added or deleted, the paper form should be updated and submitted to Enterprise Resource Planning (ERP) for updating roles in the system. Alternatively, the County could implement an electronic tracking system, possibly with the assistance of the ERP department.

Management Response

Currently, workflow authority forms are required to be submitted to the Purchasing Department at the beginning of every fiscal year. The form is available on-line to all users. The Workflow Authority Form addresses employee changes in position, transfer, retirement and termination that effect workflow. It is the responsibility of the user departments to complete the form and submit it to the Purchasing Department to complete the action. The Purchasing Department will continue to communicate with user departments the importance of reporting staff changes on the workflow authority form to the Purchasing Department as they transpire. The Purchasing Department will request the assistance of Deputy County Managers to communicate with their respective departments the importance of reporting staff changes that effect workflow to the Purchasing Department as they transpire.

In addition, the County ERP Section is currently implementing Governance, Risk, Compliance (GRC) software that provides automated, real-time Access Controls including: Implementation of Segregation of Duties (SOD) using SAP standard rule-set technology, critical access risk

reporting, and mitigating controls for access risk; Business Role Management including centralized management of SAP roles and SOD checking before role creation. Together, these solutions provide a comprehensive audit trail of user and role access and embedded SAP reporting. Additionally, ERP is in the process of researching/developing Identity Management within the Access Controls solution to enable role alignment with business processes rather than technical directory structure. When fully integrated, these solutions will provide for the effective mitigation of SOD risks and a fully compliant user-provisioning process. Estimated "go-live" of Access Controls is July 1, 2013.

4) *Centralized Receiving and Low Value Assets*

Although the current policy (Administrative Instruction AD 04) states a listing of low value assets *may be* required when deemed to be in the best interest of the County, it is best practice to always track low value items that are susceptible to theft or loss. There are a few departments that have a significant amount of low value assets for which it would be optimal to create a centralized receiving function and process. Currently the inventory management group has implemented a process to track low value assets at MDC and Public Works. Additional departments that may benefit from this process are Fire, Sheriff, and the JYDC since these departments have significant activity with low value assets.

Risk level—Moderate

Recommendation

The County should consider revising AI AD 04 to clarify when a listing should be maintained. The County should also evaluate which departments would benefit from a centralized receiving and tracking process. Implementing a process similar to MDC and Public Works would help track the low value items and reduce the risk of theft.

Management Response

The Purchasing Department will explore the possibilities of centralizing inventory control processes in county departments that have a significant amount of low value assets (i.e., Fire, Sheriff's, and YSC). The inventory processes implemented at MDC and Public Works should serve as the standard for ordering, receiving, distributing and tracking of low value assets of inventory items at applicable county departments. Individual departments should identify the level of risk in their respective areas and determine how they intend to follow best practices.

5) *Ordering/Receiving Segregation of Duties*

The County does not require segregation of duties between the employee ordering items and the employee receiving items. Although there is an approval process in place for shopping carts generated in the SAP/SRM system, that process does not fully address the risk that an employee could order items, receive them, and steal them without being identified. When duties cannot be segregated due to the size of a department, management should implement alternative controls to ensure that the goods are actually received and not stolen by the person ordering and receiving.

Risk level—Low

Recommendation

While there are other controls in place to reduce the risk of theft, it is best practice to separate the ordering and receiving functions. We understand there are departments that are small where this control will not be possible to implement; however, these duties should be separated whenever the number of employees permits.

Management Response

The Purchasing Department in conjunction with ERP staff will review Workflow Authority Forms and SRM System Roles to segregate the duties of ordering and receiving within departments that have sufficient staff. This review will be completed prior to FY14. In addition, departments will be asked to evaluate how they segregate duties and recommend ways to implement controls over ordering and receiving.

6) Public Works Warehouse Physical Access

Areas that store high value or significant amounts of inventory should be secured and monitored. The Public Works warehouse stores approximately $50,000 in inventory at any given time and has approximately $575,000 in annual expenditures. Based on the test work performed, we identified the following weaknesses in physical access controls at the Public Works inventory warehouse:

- There were no security cameras on the inside of the building to monitor activity in the storage areas.

- Entry to the inventory storage areas was not badge restricted to monitor who entered the area.

- Inventory items with high theft risk were not stored in caged areas.

Risk level—Low

Recommendation

Physical access controls are particularly important for items that have a higher theft risk. Cameras should be added to the inside of the building. This would deter theft, and if theft occurred, cameras could be viewed to identify who was responsible. Access should be restricted to only the employees who need it. Caged storage areas should hold items that are most susceptible to theft.

Management Response

Management agrees with the finding and recommendation. The Inventory Control Section of the Purchasing Department is in the process of obtaining quotes from a local vendor for the purchase and installation of three (3) video cameras for the interior of the warehouse, as well as smart card access at the entrances to the warehouse. Proper card access will be given to authorized employees.

7) *Public Works Warehouse Inventory Documentation*

The policies and procedures were not updated for fleet and facilities inventory.

Risk level—Low

Recommendation

Maintaining up to date policies and procedures for all processes that have a regular cycle of completion will improve both efficiency of performing those functions and effectiveness of maintaining accurate information in the supporting systems.

Management Response

Management agrees with the finding and recommendation. Inventory policies and procedures will be updated and formally documented by the end of April 2013.

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This report is intended for the information and use of Bernalillo County management, the audit committee, members of the Board of Commissioners of Bernalillo County and others within the organization. However, this report is a matter of public record, and once accepted its distribution is not limited.

We discussed and resolved other minor observations with management and received excellent cooperation and assistance from the various departments during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico
January 25, 2013