



Inventory Control

Internal Audit

May 2015

# Bernalillo County Internal Audit Inventory Control

## Executive Summary

### SUMMARY OF PROCEDURES

REDW performed an internal audit over the inventory control warehouses within Bernalillo County. Our internal audit focused on testing various policies and procedures and internal controls, including: receiving and issuing of inventory, inventory counts, and physical access to inventory.

We performed the following procedures:

- Obtained an understanding of operations procedures through reading relevant documentation and interviewing various personnel.
- Obtained weekly cycle count documentation for all warehouse locations for March 2015 and determined if cycle counts were performed and documentation was completed.
- Obtained annual inventory count documentation for June 2014 and determined if count was performed and documentation was completed.
- Observed physical access controls at all warehouses.
- Tested a sample of warehouse purchases to determine if items were properly entered into inventory and properly documented.
- Tested a sample of requested orders to determine if items were properly relieved from inventory and properly documented.
- Tested a sample of items in inventory to determine if inventory turnover was appropriate and to confirm there were no significant amounts of obsolete inventory.
- Performed follow-up procedures over outstanding observations relating to inventory control warehouses.

## 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 warehouses located at MDC, Automotive and Signage inventory warehouses were operating efficiently as it related to physical access and receiving and issuing goods. All controls and processes related to inventory counts at the MDC inventory warehouse were operating efficiently as well.

Significant moderate risk observations are presented below:

- **System Access Controls**—Employees from the Fleet Management Department have the ability to access auto part quantities maintained at the inventory warehouse in the M5 system. The auto parts maintained at the inventory warehouse should be segregated in the system and access to make changes to the quantities of this inventory should be limited to the Procurement and Business Services Department.

The lower risk observations are included in the attached detailed report. Additionally, we performed follow-up procedures on findings issued in previous reports. The status of these observations is 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 Procurement and Business Services Department during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico  
July 13, 2015

# Bernalillo County Internal Audit Inventory Control

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# **Bernalillo County Internal Audit Inventory Control 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 and issuing of inventory, inventory counts, and physical access controls within the inventory control warehouses. 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 May 4, 2015, and fieldwork also began the week of May 4, 2015. An exit conference was held on June 22, 2015, and final management responses were received on July 13, 2015.

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 at the inventory control warehouses for receiving and issuing of inventory in addition to inventory counts and physical access controls.

## **SCOPE AND PROCEDURES PERFORMED**

**In order to gain an understanding of the processes and operations surrounding the inventory control warehouses, we interviewed the following personnel:**

- Randy Baca, Inventory Control Administrator
- Ben Garcia, Inventory Control Coordinator for MDC Warehouse
- John Villapondo, Inventory Control Coordinator for Public Works Warehouse

- Anna Schmitt, Inventory Warehouse Specialist for YSC Warehouse
- David Gonzales, Inventory Warehouse Specialist for Fire and Rescue Warehouse

**In order to understand the inventory control process policies and procedures we read relevant portions of:**

- The Bernalillo County Inventory Control Policy and Procedures dated January 2015; and,
- Year-End Inventory Closeout 2014 process.

**We performed the following testwork:**

***Inventory Control Receiving:*** We obtained a listing of all purchases of inventory items from January 2015 through March 2015. We selected a statistical sample from each Warehouse (Automotive, Signage, MDC, YSC and Fire/Rescue) for a total sample of 84 items using a 90% confidence level (CL) and 10% tolerable deviation (TD) and tested to determine if:

- Delivery receipts were matched to purchasing documents.
- Verification of delivery was documented by employee receiving the shipment.

***Inventory Control Issuing:*** We obtained a listing of all inventory items issued between January 2015 and March 2015. We selected a statistical sample (using a 90% CL and 10% TD) from each Warehouse for a total sample of 100 items and tested to determine if:

- Items issued were requested by other departments.
- Items were properly removed from inventory.
- Receipt of issued items was documented.

***Inventory Cycle Counts:*** We requested documentation of all weekly cycle counts performed at each warehouse for March 2015. We tested that all cycle counts were completed and any variances identified were researched and adjusted properly. We also tested that the annual inventory counts were completed and any variances identified were researched and adjusted properly.

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

***Inventory Obsolescence:*** We obtained a listing of all items in inventory at each warehouse including the dates the items were last received. We selected a statistical sample (using a 90% CL and 10% TD) from each Warehouse for a total sample of 100 items and determined if the item had been in stock longer than six months.

***Follow-up Procedures:*** Procedures are outlined in the follow-up section at the end of the report.

## **OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES**

We identified the following weaknesses relating to the Bernalillo County's processes:

### ***1) System Access Controls***

The inventory control warehouse uses M5 system to track auto parts inventory. This system is managed by the Fleet Management Department. During implementation of M5, user access controls were not limited allowing Fleet Management employees to have access to the inventory control warehouse auto parts inventory in M5. We found one instance during our testing where an item that was not maintained in inventory was inaccurately adjusted in the system by a Fleet Management employee.

**Potential Risk: Moderate**—Access to the inventory warehouse in M5 by employees of other departments can result in inaccurate tracking of inventory items and discrepancies during cycle counts.

**Recommendation:** Fleet Management IT Support and Procurement and Business Services should work together to ensure appropriate personnel have access to the inventory warehouse in M5.

**Management Response:** Management agrees with the finding. Fleet Management has reached out to the M5 vendor to determine if access can be restricted in the inventory section of M5 for the two Fleet/Facilities employees.

### ***2) Obsolete Inventory***

Inventory items should be monitored for usage to ensure items are not over stocked and are needed. Inventory levels should also be adjusted as business needs change. Of the 100 items tested, 55 items were received prior to October 2014. Several of these items were received prior to January 2014. There does not appear to be a documented process to monitor and evaluate if current inventory is obsolete.

**Potential Risk: Low**—Large volumes of unused inventory increase the risk of misappropriation of inventory or inventory count errors as there are more items available to steal and more items to count.

**Recommendation:** The County should analyze all inventory items for usage. Inventory items that are not being used by the inventory control warehouses should be allocated to other County departments or donated. A process should be developed to analyze inventory levels needed and ensure inventory will not become obsolete. While a documented process was not in place, the Procurement and Business Services department has worked to improve the process by implementing inventory levels and by taking steps to dispose of obsolete inventory.

**Management Response:** Management agrees with the finding and recommendation. Current internal processes will be revised to include that analysis of inventory levels to ensure inventory will not become obsolete.

While the need to analyze inventory levels and content was not specifically spelled out in the current internal processes, it does occur, as described below.

As part of its inventory warehouse management activities, the Inventory Warehouse Management Section regularly performs inventory level and corresponding product aging and use analysis as part of its “cycle count” process. For example, over the past three (3) years the Section has purged considerable amounts of unused and/or obsolete supplies from the automotive parts and sign materials warehouses. In addition, large volumes of unused custodial supplies were transferred to the Metropolitan Detention Center (MDC) where we knew they would be consumed. Those actions freed up enough warehouse floor space to allow for the construction of a “cleanroom” for the newly implemented printing and graphics operations.

It should also be noted that the Inventory Warehouse Management Section does follow the County’s formal process for the removal and/or disposition of assets. Those policies and procedures were documented in the County’s intranet site (Insider). Items removed were either returned to the vendor for a credit or scrapped to the Fixed Assets Section for sale on the County’s Surplus Property site.

We need to also emphasize that the Inventory Warehouse Management Section does not remove items from inventory without prior discussion with and approval from the user department(s). For example, at the MDC warehouse, the inventory supervisor meets regularly with center management to discuss inventory levels, and whether to remove and/or add inventory items.

### ***3) Inventory Cycle Counts***

Policies and procedures require inventory cycle counts to be performed weekly and documentation of these cycle counts is to be maintained by each warehouse. Automotive and Signage warehouses completed two of the four weekly counts selected for testing. The YSC warehouse also completed two of four weekly counts selected for testing. Additionally, the Fire/Rescue warehouse completed all four counts but did not maintain documentation showing completion of the counts.

**Potential Risk: Low**—Cycle counts allow for timely reconciliation of physical inventory to the systems used to track inventory. If timely reconciliation does not occur, the risk of inventory variances due to theft or error increases. While there were no variances in cycle counts performed, documentation of cycle counts allows employees to properly research variances when they do occur.

**Recommendation:** Cycle counts should be performed and documented in accordance with established policies and procedures. If the Procurement and Business Services department feels weekly cycle counts are not efficient and needed, the policies should be adjusted accordingly to allow for bi-weekly or monthly counts.

**Management Response:** Management agrees with the finding and recommendation, and will revise its current processes to allow for the performance and proper documentation of bi-weekly cycle counts at all warehouses (except for the MDC warehouse) under the responsibility of the Inventory Warehouse Management Section. Due to the size of the MDC warehouse, and the frequent use of inmate help, the Section will continue to perform weekly cycle counts. The revision of these procedures will be completed and documented by December 31, 2015.



#### **4) Policies and Procedures**

Procurement and Business Services took control of the YSC warehouse and Fire/Rescue warehouse at the end of 2014. As such, Procurement and Business Services have been working to bring all controls at the new warehouses up to the same standard as the existing warehouses (Automotive, Signage and MDC). There are currently controls in place at the existing warehouses that are not included in the procedures for the YSC and Fire/Rescue warehouses. These procedures include signatures of employees on receiving documentation and signatures of receiving departments on deliveries. Additionally, the Fire/Rescue warehouse currently follows procedures that differ from the documented procedures. While the procedures appear to be sufficient to mitigate risks, the procedures should be properly documented.

**Potential Risk: Low**—Consistent policies and procedures increase efficiencies of processes.

**Recommendation:** Controls in place at the existing warehouses should be documented and implemented at the YSC and Fire/Rescue warehouses. Additionally, Fire/Rescue procedures either need to be updated to reflect the current processes or the current processes need to be adjusted to match the documented procedures.

**Management Response:** Management agrees with the finding and recommendation. The Inventory Management Section in transitioning the YSC and Fire/Rescue warehouses has met and/or will meet with the user department managers to discuss a process which best meets their needs, while maintaining adequate internal controls. During the course of this fiscal year, discussions have been held with YSC management, and changes have already been implemented to mirror those of the MDC warehouse, as each warehouse supports a correctional facility. Fire and Rescue inventory process changes will be recommended and implemented after discussions with the newly hired Fire Chief have taken place. A meeting will be planned for the month of July and the processes should be revised by December 31, 2015.

### **FOLLOW-UP ON PRIOR YEAR OBSERVATIONS**

Follow-up testing was performed on the Receiving and Issuing internal audit report from December 2012. The status of each observation below was determined through inquiry, observation, and/or testing:

#### ***Prior Year Observation – 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.

**Current Status: Resolved**—We tested cycle counts for the Public Works warehouses for the month of March 2015. There were no variances in the cycle counts as the system generated counts matched the physical counts. Additionally, there was a process in place to follow-up on variances if they occurred.

***Prior Year Observation – 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 FY2012 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.

**Current Status: Resolved**—We tested the year-end inventory count for the Auto Parts inventory. There were no variances in the year-end inventory and no adjustments were made. We also reviewed policies and procedures for the warehouses which include procedures for investigation and research of variances.

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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 Procurement and Business Services department during the course of our interviews and testing. We sincerely appreciate the courtesy extended to our personnel.

REDW LLC

Albuquerque, New Mexico  
July 13, 2015