Office of Internal Audit

Performance Audit 19-03: Fleet Garage Inventories

December 2019

City Auditor
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Senior Auditor
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OFFICE OF INTERNAL AUDIT
Stan Sewell, City Auditor

December 16, 2019

To: Mayor Andy Berke
        City Council Members

Subject: Fleet Garage Inventories Audit (Report #19-03)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of Fleet garage inventories. We found policy and procedures manuals were not in place and internal controls need to be strengthened. During the course of our audit we noted the attitudes and morale of the parts staff was positive.

In order to address the noted areas for improvement, we recommended actions to develop written policy and procedures to strengthen internal controls and better secure the tool rooms.

We thank the management and staff of the Fleet Services Division and Finance Department for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
        Stacy Richardson, Chief of Staff
        Maura Sullivan, Chief Operating Officer
        Justin Holland, Administrator, Public Works
        Gary Franks, Director, Fleet Management
        Daisy Madison, Chief Financial Officer
        Jim Arnette, Tennessee Local Government Audit

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2019 Audit Agenda. The objectives of this audit were to determine if comprehensive policies, procedures and guidelines are in place to ensure proper, effective handling of parts inventory.

BACKGROUND

The Fleet Division is responsible for the repair of most vehicles and heavy equipment owned by the City. Repairs are performed at two garages. The Amnicola garage is responsible for the repair of fire equipment, police vehicles, other cars and small trucks. The 12th Street garage is responsible for the repair of large trucks and equipment. To complete repairs the garages order parts in excess of $2,000,000 annually. There are thirty mechanics who repair vehicles, fifteen each at Amnicola and 12th Street Garages.

The Fleet Division uses an inventory management system to track parts inventory and manage vehicle and equipment repairs. Fleet Services staff enter inventory into the Robert Turley Associates (RTA) inventory management system as parts and equipment are purchased and then enter invoices for payment into the city's Oracle system. RTA is a standalone system and does not interface with Oracle or any other system - information must be manually entered into each system separately.

Parts employees use the system to manage inventory, charge parts to work orders and monitor parts usage to determine when to order parts for stock. Fleet personnel also use the system to track the history of work performed on each vehicle.

When parts are received, parts room personnel verify receipts against the quantity ordered and enter the receipt into RTA inventory. [1] The Inventory Coordinator at Amnicola and the Asset Management Coordinator at 12th Street (Coordinators) are responsible for entering parts requisitions into the Oracle ERP system upon order. They also indicate the receipt of parts into Oracle, facilitating payment of the associated invoices.

When a vehicle comes to fleet services for service/repair, a work order is created in RTA detailing work to be completed. When a part is needed to repair the vehicle, the mechanic requests the part from parts

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[1] An exception to this procedure is special ordered parts, which bypass inventory.

desk personnel. If the part is in stock, the parts room employee issues the part to the mechanic to complete the repair. If the part is not in stock, the parts employee orders the part (using a release against a blanket Purchase Order).

When a part is issued to the mechanic, a parts room employee charges the part to the applicable work order, removing it from inventory. After repairs are completed, proper labor hours are applied to the work order through the RTA system. Supervisors are responsible for reviewing work orders to confirm the items/amounts billed are accurate.

Parts inventory value in the Oracle system is adjusted annually, based upon totals from the computation of the annual physical inventory.

Financial Information

Fleet Division Inventory Purchases

Fiscal 2015-2019

Total Fleet Parts Inventory Purchases vs Budget

Fiscal Year	Actual	Budget	Fav/(Unfav) Variance	Year end Inventory Balance
2015	$ 3,315,756	$ 2,925,731	$ (390,025)	$ 1,074,253
2016	3,004,295	2,969,922	(34,373)	1,149,403
2017	2,720,159	3,006,572	286,412	1,032,193
2018	2,509,360	3,108,507	599,146	1,179,195
2019	2,796,131	2,536,275	(259,856)	1,374,426
	$ 14,345,702	$ 14,547,005	$ 201,304	

12th Street Garage

Fiscal Year	Actual	Budget	Fav/(Unfav) Variance
2015	$ 1,543,576	$ 1,462,214	$ (81,362)
2016	1,283,081	1,447,757	164,676
2017	1,327,599	1,440,445	112,846
2018	1,076,466	1,487,024	410,558
2019	1,568,886	1,027,903	(540,983)
	$ 6,799,608	$ 6,865,343	$ 65,735

Amnicola Garage

Fiscal Year	Actual	Budget	Fav/(Unfav) Variance
2015	$ 1,772,180	$ 1,463,517	$ (308,663)
2016	1,721,214	1,522,164	(199,050)
2017	1,392,560	1,566,127	173,566
2018	1,432,895	1,621,483	188,588
2019	1,227,245	1,508,371	281,126
	$ 7,546,094	$ 7,681,662	$ 135,568

Source: Oracle Records

FINDINGS AND RECOMMENDATIONS

Internal controls need to be strengthened.

Internal control encompasses systematic measures (such as reviews, checks and balances, methods and procedures) instituted by an organization to:

1. Conduct its business in an orderly and efficient manner;
2. Safeguard its assets and resources;
3. Deter and detect errors, fraud, and theft;
4. Ensure accuracy and completeness of its accounting data;
5. Produce reliable and timely financial and management information, and
6. Ensure adherence to its policies and plans. [2]

A current written policy and procedure manual is not in place.

There is no current formal, written, policies and procedures manual. Fleet Division staff have developed procedures for parts inventory handling. However, they are not formalized or approved by Fleet management.

Component 1, Control Environment of the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee* requires the development of a manual that provides sufficient documentation of internal control to communicate to personnel their responsibilities, as well as to monitor and evaluate the controls.

New employees, or employees performing unfamiliar tasks, do not have an authoritative source to access with inquiries. When personnel change, some necessary procedures could be omitted, or performed incorrectly, possibly leading to a loss of inventory.

Recommendation 1:

We recommend Fleet management develop a Policy and Procedure Manual, including sections addressing parts purchasing, handling and issuance to work orders. This recommendation was also made in Audit 09-11 and Audit 11-05.

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[2] Businessdictionary.com

Auditee Response: We concur with the audit finding and recommendation. Policies and procedures are currently being developed following standards of the American Public Works Association guidance for parts and inventory management.

Special order parts are not entered into and relieved from inventory.

Special order parts are charged directly to a work order upon receipt. They are not entered as a purchase and release through inventory. Garage personnel have been instructed to not enter special order purchases into and disburse them from inventory to a work order. This results in an incomplete audit trail. Additionally, when garage personnel require information about a part (for warranty purposes, etc.), they must search through work orders.

The *Internal Control and Compliance Manual for Tennessee Municipalities,* Component 3, Control Activities, #1, indicates management should design control activities to achieve objectives and respond to risks. Perpetual inventory and usage records by employee are shown as examples of this control. Tennessee Code Annotated (T.C.A.) 9-18-102 requires management provide reasonable assurance the risk of loss due to fraud or abuse is decreased. City Code Section 2-5 requires each organizational unit of the City to keep a perpetual inventory of the property under its control. Common business practice and standard accounting principles require tracking the purchase, receipt, handling and disposition of inventory purchased with a complete audit trail.

Maintenance of a perpetual inventory system ensures accurate management information is available for decision making and enhances the prevention of fraud, waste and abuse.

Recommendation 2:

We recommend all special order part purchases be entered into RTA and disbursed following normal procedures.

Auditee Response: Fleet agrees with the premise that all parts should be tracked. We will examine processes that will allow for proper tracking of special order parts.

Controls over inventory adjustments need to be strengthened.

When the quantity of a part on hand at the 12th Street garage is found to not match RTA, the quantity in RTA is adjusted to show the actual

quantity on hand. Changes are not approved by management, nor are records kept detailing the change.

When the Amnicola location finds a discrepancy they try to find the cause of the difference. If not found, the inventory figures are changed to actual quantity with no supporting records and without supervisor approval.

Component 3, Control Activities, of the *Internal Control and Compliance Manual for Governmental Entities and Other Audited Entities in Tennessee,* requires segregation of duties, (e.g., identifying variances and associated approval) for purpose of deterring fraudulent activities.

Adjustments are made to inventory counts without management approval. Management does not review monthly adjustment reports, hindering their ability to spot trends and discourage theft.

Recommendation 3:

We recommend procedures be developed and put in place to ensure manual adjustments to inventory records are approved by management, backup for any adjustment be retained and management review adjustment reports at least monthly.

Auditee Response: We concur with the audit finding and recommendation. We are in the process of developing a procedure that will include approval of inventory adjustments.

Parts charged to work orders and returned are not added back to inventory.

At the 12th Street garage unused special order parts are charged to the vehicle work order for which they were ordered, and if unused, not credited back to the workorder and returned to inventory. Those unused parts are stored on a rack with other parts not included in inventory. When a part is returned to the parts room it should be immediately reversed from the work order and returned to inventory.

The cost of repair for the work order is overstated and the value of inventory understated. Also, the same part may be unnecessarily ordered again due to being in stock but not included in inventory.

Recommendation 4:

We recommend Fleet put a policy in place to ensure parts that have been charged to a work order and returned to the parts room be immediately reversed from the work order and entered in inventory.

Auditee Response: We concur with the audit finding and recommendation.

Parts room access should be limited.

The 12th Street garage parts room is accessed by a non-locking door to the repair bays, as well as a window to pass parts back and forth. Access is not limited to parts room employees. If parts room personnel are busy, mechanics are encouraged to retrieve needed parts and inform parts room personnel of the parts removed. This opens the possibility inventory can be removed and not charged to a work order, by either neglect or theft. Also, the ease of theft increases greatly when access to inventory is not limited.

The Amnicola garage parts room has locking doors and a counter separating the mechanics from the parts room. The mechanics have been instructed not to go past the counter.   The doors to the parts room are locked when parts room personnel are not present. Keys to the parts room are held by management and parts room personnel. If parts are needed on the weekend a supervisor on site will pull the parts, note it on the applicable work order, and parts room personnel will charge the inventory to a work order the following Monday.

The Internal Control Manual for Local Government Entities and other Audited Entities in Tennessee, in the Control Activities section, requires control activities be placed at various functional levels to mitigate risk. Safeguarding inventory is one of those functional levels and appropriate safeguards should be in place to do so.

Recommendation 5:

We recommend Fleet limit access to parts room personnel at the 12th Street garage using a system similar to that at the Amnicola garage.

Auditee Response: We concur with the audit finding and recommendation. Fleet management has begun the process of contracting to install magnetic locks on all parts room doors.

Sufficient spot checks of inventory are not performed.

Spot checks of inventory are not performed on a regular, organized basis. Performing regular spot checks increases the possibility systemic inventory loss will be identified and addressed in a timely manner.

The 12th Street garage conducts spot checks on parts chosen by parts room personnel. The Amnicola Garage no longer performs spot

counts of inventory. When spot checks were performed, the lists utilized contained the quantity, decreasing the chance of accurate on-hand counts. Not knowing the expected number of units can lead to a more valid item count.

The Internal Control Manual for Governmental Entities and other Audited Entities in Tennessee includes: Control activities – the actions management establishes thorough policies and procedures to achieve objectives and respond to risks in the internal control system.

Recommendation 6:

We recommend Fleet begin regularly performing spot checks on parts inventory. The list of items should not contain the expected quantity on hand. Documentation of the spot checks should be approved by management after completion, scanned and retained. This function should also be included in the policy and procedures manual.

Auditee Response: *We concur with the audit finding and recommendation.*

Inventory management needs to be improved.

Automated reorder points in RTA are not periodically reviewed for accuracy.

Automated reorder points are amounts set to notify staff to reorder when inventory levels fall below a certain level. Automated reorder points and ordering for inventory can reduce downtime for vehicles and equipment, as well as reduce costs.

Using properly managed automatic reorder points allows parts to be reordered as the quantity approaches zero. However, to be of value, a regular process must be in place ensuring the usage supporting the reorder points and order amounts have not changed.

If the optimum quantity of parts are kept on hand, funding of inventory is decreased, downtime for equipment limited and mechanic efficiency is improved. Any savings are dependent on proper procedures being in place, ensuring reorder points meet ongoing usage needs for each part.

Many parts in RTA inventory have been set up with automatic reorder levels and quantities. A procedure is not in place to periodically review reorder points for vehicles being phased out, or parts experiencing slowing use. This creates the danger of quantities of parts being ordered automatically, kept on hand for a long period of time, then appearing on the obsolete listing for disposal. The only safeguard currently in place is if parts room personnel notice a part on the reorder form and realize the associated part/vehicle is being phased

out. The cost of unused inventory can easily offset any benefit received from automatic reorder points.

Recommendation 7:

We recommend a methodology be developed to regularly reassess reorder points for all parts with automatic reorder points.

Auditee Response: We concur with the audit finding and recommendation

The RTA Obsolete Parts Report is not in use throughout the Division.

An RTA report is produced annually showing parts with no use in the past three years. The Amnicola garage uses the report as a guide to gather obsolete parts and remove them from inventory. An exception is parts for fire equipment. Fire equipment parts may not be used regularly, but are kept on hand while the vehicle continues in service. The 12th Street garage does not use the Obsolete Parts Report.

Carrying inventory that is obsolete utilizes limited floor space in the parts rooms and often reduces the value when the obsolete inventory is sold.

Recommendation 8:

We recommend a policy be written and enforced that obsolete inventory be reviewed at a set period of time after its last use to determine if it should remain in inventory.

Auditee Response: We concur with the audit finding and recommendation.

RTA purchasing and Oracle A/P are not interfaced.

The possibility of human error increases with each instance of manual data entry. Automated data processing results in fewer processing errors and reduced transaction costs. Currently, parts employees order parts, either by phone or fax and forward the information to the coordinator at the garages. The information is entered by the coordinator in Oracle against the purchase order, encumbering the funds to pay for the requisition when invoiced. After the parts arrive and are received into RTA, parts personnel forward the invoice to the coordinator, where it is scanned and receiving actions performed in Oracle to begin the payment process.

Receiving information from RTA is not forwarded to the office so there is no affirmation all items were entered into RTA. There is a breakdown in internal control because there is no mechanism ensuring

the quantity of items entered into RTA match the paid invoice quantity. Receipt of product is entered manually into both RTA and Oracle, but not matched. This is a duplication of effort and causes an increased possibility of data entry error and increases the opportunity for fraud.

When purchases are made using a purchase card, parts personnel order items over the phone or email, or send an employee, and the card, to pick up the items. Parts personnel receive the items into RTA. The receipts are retained to be reconciled to the monthly P-card statement. When items on the statement have been reconciled, it is forwarded, with the backup attached, to the coordinator for payment.

IT project management personnel indicated interfacing receipts in RTA with Oracle was possible, and similar interfaces have been created for other software in the City. There would be some cost, but not an unreasonable amount.

Recommendation 9:

We recommend Fleet work with IT to develop an interface between RTA and Oracle for inventory receipts. In the interim, we recommend a receiving document from RTA be presented with the invoice and the amounts be reviewed prior to entry into Oracle, strengthening internal control.

Auditee Response: We concur with the audit finding and recommendation. There is currently an RFP in process to upgrade for an inventory management system. This recommendation will be addressed as part of that process.

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers Fleet Parts Inventory activities for fiscal years 2018 and 2019. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from the Fleet and Finance Departments. Original records as well as copies were used as evidence and verified through physical examination.

To develop our recommendations, we interviewed Fleet personnel and conducted analysis of Fleet parts inventory processes and industry best practices.

Judgmental sampling was used to improve the overall efficiency of the audit.

Computerized data used in the audit was taken from the city financial system and RTA. The City financial system has been deemed to be reliable in the past. We discovered during the preliminary phase of this audit that all purchases of inventory parts are not entered into inventory. The determinations of this audit were not based on totals from RTA, and were not used for the purposes of drawing conclusions.

We conducted this performance audit from June 17, 2019 to November 18, 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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