



Internal Audit Report

Facilities Management Inventories July 2003



Audit Team Members

Joe Seratte, Audit Manager

Louise Wild, Staff Auditor

Laurie Aquino, Staff Auditor



Maricopa County

Internal Audit Department

301 West Jefferson St
Suite 1090
Phx, AZ 85003-2143
Phone: 602-506-1585
Fax: 602-506-8957
www.maricopa.gov

July 8, 2003

Fulton Brock, Chairman, Board of Supervisors
Don Stapley, Supervisor, District II
Andrew Kunasek, Supervisor, District III
Max W. Wilson, Supervisor, District IV
Mary Rose Wilcox, Supervisor, District V

We have completed our FY 2002-03 review of Facilities Management inventories. The audit was performed in accordance with the annual audit plan that was approved by the Board of Supervisors.

The highlights of this report include the following:

- Facilities Management should enhance controls over the parts inventory records, valuation, and safeguards
- Facilities Management should enhance controls over the surplus office furniture inventory.

Attached are the report summary, detailed findings, recommendations, and Facilities Management's response. We have reviewed this information with the Director and appreciate the excellent cooperation provided by management and staff. If you have questions, or wish to discuss items presented in this report, please contact Joe Seratte at 506-6092.

Sincerely,

A handwritten signature in cursive script that reads "Ross L. Tate".

Ross L. Tate
County Auditor

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Executive Summary

Parts Inventory - Recording (Page 5)

Facilities Management (FMD) has not accurately recorded inventory activity and has not included all parts and supplies in inventory counts. Incomplete inventory records misstate inventory value, make parts susceptible to misuse, and affect procurement decisions. FMD should add all unrecorded parts to inventory records, record inventory activity timely, and include all parts and supplies in year-end inventory counts.

Parts Inventory – Safeguards (Page 7)

Current job responsibilities at FMD do not include adequate segregation of duties between inventory custody and record keeping, and inventory custody and physical inventory functions. When duties are not appropriately segregated theft and misuse can occur and not be detected. FMD should segregate inventory custody from record keeping and inventory custody from physical inventory count duties to the extent reasonably possible.

Parts Inventory - Valuation (Page 9)

FMD values inventory using the moving average basis, and charges parts using the standard cost basis, without analyzing the variances. Over time, these variances can distort the carrying value of inventory, as well as the costs of parts charged to other departments. FMD should perform periodic analysis of variances between the moving average and standard cost of parts and adjust the standard cost accordingly.

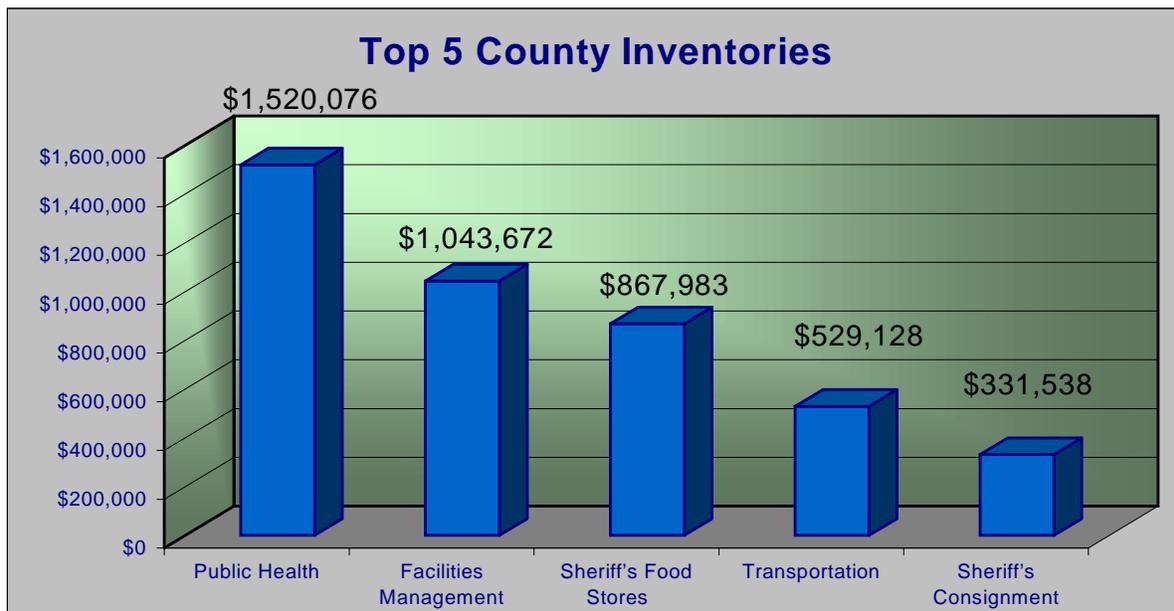
Surplus Office Furniture (Page 10)

FMD has not maintained effective control over County surplus office furniture. Uncontrolled inventories are susceptible to theft and misuse. FMD should establish controls sufficient to safeguard the surplus office furniture inventory.

Introduction

Background

The Countywide Inventory audit is part of the Board of Supervisors (BOS) approved Annual Audit Plan for fiscal year 2003. The objective of the audit was to ensure that County inventories are properly valued, reported, and safeguarded. County departments reported a total of \$7,320,000 in inventories at the close of fiscal year 2002. The five most significant inventories are shown in the chart below.



Audit performed a risk assessment of the five inventories listed and selected the Facilities Management (FMD) inventories for testing. Although Public Health has a higher dollar value of inventory, their inventory issues were addressed in a prior audit.

Facilities Management Inventory

FMD maintains an inventory of parts and supplies for use in repairing and maintaining County facilities. Inventory records submitted to the Department of Finance (DOF) at the end of FY 2002 reported over 9,000 different parts with a value of \$1,043,672, a 62 per cent increase from the prior year. FMD uses a specialized inventory tracking software package, Maximo®, to track parts and supplies. FMD also maintains an inventory of surplus office furniture that is housed in the warehouse at 5th Avenue and Jackson. FMD does not track this inventory, but estimates that it is valued at a minimum of \$80,000.

DOF requires FMD to perform a physical inventory each fiscal year. DOF combines the FMD year-end inventory count value with other governmental activity year-end inventory counts to arrive at the total governmental activities inventory reported in the County's Comprehensive

Annual Financial Report (CAFR). DOF also uses this information to calculate inventory expense for the year under new governmental accounting standards (GASB 34), which is ultimately included in general government expenses in the CAFR.

Internal Audit performed the last audit of FMD in fiscal year 2002 and noted control weaknesses related to inventory at that time. Subsequently, FMD reviewed its inventory process and began a comprehensive overhaul of its inventory system five weeks prior to the start of this audit. During the audit, physical counts of inventory and an update of the inventory tracking system were completed.

Scope and Methodology

Our audit objectives were to determine if:

- FMD inventory records are accurate and complete
- FMD inventory is appropriately valued
- FMD inventory controls ensure assets are appropriately safeguarded

This audit was performed in accordance with generally accepted government auditing standards.



Facilities Management stores surplus office furniture in the old Santa Fe railroad building



Department Reported Accomplishments

Facilities Management has provided Internal Audit with the following information for inclusion in this report.

Operations and Maintenance Parts Inventory

In April 2003, prior to the notification of the audit, FMD initiated an inventory review to resolve concerns raised by staff. The concerns included:

- Standardization of part descriptions in Maximo
- Accuracy of inventory by location in Maximo
- Hours of operations of main parts rooms at Downtown and Durango
- Utilization of Maximo system for re-order points
- Reduction of inventory to just-in-time levels; Supply Chain Management: Vendor-FMD-Customers /Trades Trucks, Warehouses
- Establishment of proper controls and procedures
- “Best use plan” for new Durango warehouse based on existing personnel resources
- Interface with PeopleSoft, Maximo’s Accuracy and Proper use

To address these concerns, FMD retained the services of highly qualified personnel from Materials Management. To date we have achieved the following:

- All significant storage areas have been inventoried and the system has been adjusted to reflect the current inventories by location
- Inventory cycle counting classes have been conducted for all trades employees. Ongoing, daily cycle counts are conducted in all areas
- Material Review Board (MRB) – has been formed and is disposing of obsolete parts
- Auditing of Trades Trucks and Warehouses
- Benchmarking of similar organizations was completed and an inventory policy was created based on best practices used in Fairfax County.
- Meetings with Management/Steering Committee occur weekly;
- The establishment of an 80/20 list to identify high usage contract vendors and the implementation of a pilot program to partner with highest usage vendors.

Systems Furniture

FMD has completed a reconciliation of the current inventory and will seek to sell all remaining excess furniture through a “Revenue Bid” and deposit the proceeds into the General Fund. This will effectively remove FMD from this type of work in the future or until resources can be obtained to efficiently manage excess furniture. We will continue to utilize existing furniture in our design and construction efforts as is practicable.

Issue 1: Parts Inventory - Records

Summary

Facilities Management (FMD) has not accurately recorded inventory activity and has not included all parts and supplies in inventory counts. Incomplete inventory records misstate inventory value, make parts susceptible to misuse, and affect procurement decisions. FMD should add all unrecorded parts to inventory records, record inventory activity timely, and include all parts and supplies in year-end inventory counts.

Applicable Standards

The United States General Accounting Office (GAO) Financial Audit Manual (July 2001) states that controls over inventory should be sufficient to ensure that inventory records are complete and accurate and allow management to monitor inventory levels to better control operations and make procurement decisions. In addition, The Uniform Accounting Manual for Arizona Counties (UAMAC) requires inventory counts of periodic systems be performed annually in a systematic manner to avoid double counting and omissions.



The Jackson storeroom is located in the parking garage behind the old Santa Fe building

Inventory Testing

We selected a sample of 40 items from FMD parts inventory records and physically counted them at the Jackson and Durango storerooms without exception.

We selected a second sample of 58 parts physically located at the Jackson and Durango storerooms and the Sheriff's warehouse. We attempted to trace them to FMD inventory records with the following results:

- 41 items had current part numbers and, with minor exceptions, were properly recorded in FMD inventory records
- 17 items did not have current part numbers and were not included in inventory

Two of the unrecorded items are electric drives and motors located in the Sheriff's Warehouse, and valued at \$58,000 of the total of \$64,000 we noted as unrecorded. Additional amounts are unrecorded, but a dollar value for the parts could not be readily established. Most of these items are under review by FMD to determine if they represent useful or obsolete inventory. The items will be entered into the system based on the results of this review.

Prior FMD Inventory Reconciliation

Prior to the audit, FMD began a comprehensive overhaul of its inventory system. FMD had completed physical counts of parts and adjusted its inventory tracking system, Maximo®, accordingly. In our testing, no exceptions were found when validating the existence of inventory items recorded in the FMD inventory system. However, notable exceptions were found when tracing parts into FMD inventory records. These results indicate that the FMD inventory reconciliation accurately adjusted items recorded in the system, but did not identify, and include in the inventory, all parts in their warehouse locations.

Impact

Inconsistent recording of inventory items and inventory activity distorts the value of inventory makes parts susceptible to theft and misuse, and impedes efficient procurement decisions.

Recommendation

FMD should:

- A. Include all unrecorded parts and supplies in the current inventory records.
- B. Record parts inventory activity timely.
- C. Count all parts and supplies in the year-end physical inventory.

Issue 2: Parts Inventory - Safeguards

Summary

Facilities Management current job responsibilities do not include adequate segregation of duties between inventory custody and record keeping, and inventory custody and physical inventory functions. When duties are not appropriately segregated theft and misuse can occur and not be detected. FMD should segregate inventory custody from record keeping and inventory custody from physical inventory count duties to the extent reasonably possible.

Applicable Standards

The GAO Financial Audit Manual states that controls over inventory should be sufficient to maintain adequate physical security and accurate records. Therefore, agencies should perform physical inventory counts on a regular basis, properly investigate and document inventory adjustments, and effectively segregate functions that if combined could facilitate undetected theft.



Paper cycle count sheets are used until permanent cycle count cards arrive

Inventory Cycle Counts

FMD conducts physical inventories by using cycle counts. Cycle counts are performed by counting a small selection of inventory items every day. Cycle counts are an effective tool for monitoring inventory levels, discouraging inventory misuse, and detecting misuse quickly, should it occur. Cycle-count procedures appear adequate with the exception of segregation of duties.

Segregation of Duties

It is important to separate physical custody of assets from the ability to change accounting records for those assets. This division of responsibility helps prevent assets from being misdirected, without being detected.

Current job responsibilities over FMD inventory do not provide sufficient segregation of duties to ensure FMD assets are protected.

Conflicting responsibilities include:

- The warehouse custodian also makes adjustments to the inventory system. (As a compensating control FMD is introducing a monthly adjustment report for review by the deputy director.)
- FMD personnel with inventory custody also perform physical inventory counts
- Cycle-counters also select the samples to be counted

Impact

When duties are not appropriately segregated, misuse can occur and not be detected.

Recommendations

To the extent reasonably possible, FMD should:

- A. Segregate physical custody of inventory from responsibility for counting inventory.
- B. Segregate physical custody of inventory from inventory record keeping.
- C. Select cycle-count samples at random and provide the samples to the cycle -counters.

Issue 3: Parts Inventory - Valuation

Summary

Facilities Management values inventory using the moving average basis, and charges parts using the standard cost basis, without analyzing the variances. Over time, these variances can distort the carrying value of inventory, as well as the costs of parts charged to other departments. FMD should perform periodic analysis of variances between the moving average and standard costs of parts and adjust the standard cost accordingly.

Applicable Standards

Generally Accepted Accounting Standards require that significant amounts of inventory be reported on the balance sheet. The DOF Year End Closing Package directs County departments to value inventories greater than \$50,000 using the moving average basis. In addition, generally accepted accounting principles dictate that when standard costing is used, variances should be analyzed periodically and standard costs adjusted accordingly.

Valuation Methodology

FMD's inventory management system, Maximo®, uses the moving average basis to value recorded parts. The parts room personnel establish the cost of each part based on price and costs to get it into inventory (shipping, etc) and enter the cost into the system as the parts are received. However, when a part is removed from inventory, it is removed and charged at standard cost – a constant value determined by the department and recorded in the system. Currently, the variance between moving average and standard cost is not analyzed so the size of the variance and the accuracy of the standard cost has not been determined.

Unrecorded Inventory

In addition to the method of valuing inventory, inventory count testing, discussed in Issue 1, showed that there may be significant amounts of inventory items not recorded in the FMD inventory system.

Impact

Omitting parts/supplies from the year-end inventory count understates the value of governmental activities inventory in County financial statements and variances between moving average and standard cost methods can distort the value of inventory over time if not addressed. In addition FMD is unable to ensure that the standard cost of parts charged to jobs reflects FMD's actual cost.

Recommendation

FMD should:

- A. Include all parts and supplies in the inventory counts.
- B. Perform periodic analysis of variances between the moving average and standard costs of parts and adjust the standard cost according

Issue 4: Surplus Office Furniture

Summary

Facilities Management (FMD) has not maintained effective control over County surplus office furniture. Uncontrolled inventories are susceptible to theft and misuse. FMD should establish controls sufficient to safeguard the surplus office furniture inventory.

Applicable Standards

The standards quoted in Issues 1 – 3 concerning the recording, valuation, and safeguarding of inventories also apply to the surplus office furniture inventory.

Surplus Inventory Responsibility

FMD maintains approximately 15,000 square feet of surplus office furniture in its warehouse at 5th Avenue and Jackson. This inventory is used County furniture sent to surplus when new furniture is acquired, or the need for the furniture no longer exists.

Surplus Inventory Controls

The last physical count and valuation of this inventory was performed in 2001. The inventory has grown substantially since the last inventory, but FMD has not maintained records of additions or removals. Access to the inventory is not sufficiently controlled.

County personnel and contractors who wish to access the warehouse sign a key out from the FMD front desk and return it when they're done. During the audit the

warehouse was found to be unlocked and one or more bay doors open all day due to contractors performing construction work.

In addition, the condition of the inventory has declined significantly over the last two years due to poor storage conditions. FMD personnel estimate the current value inventory is at least \$80,000, however, due to the condition of the warehouse and the lack of record keeping, audit could not validate the accuracy of this estimate.



Surplus furniture inventory was not maintained in an orderly fashion

Impact

Lack of significant control over the surplus office furniture inventory makes the inventory susceptible to misuse and impedes efficient procurement decisions.

Recommendation

Facilities Management (FMD) should establish controls sufficient to safeguard surplus office furniture inventory:

- A.** Prepare a formal inventory of all surplus furniture
- B.** Establish control over all additions and distributions of furniture inventory
- C.** Record all additions and distributions of furniture inventory

Department Response



Maricopa County

Facilities Management Department

401 W. Jefferson Street
Phoenix, Arizona 85003
Phone: (602) 506-8227
Fax: (602) 506-4275

Date: June 18, 2003
To: Ross L. Tate, County Auditor
From: Steven J. Conner, Director 
Subject: Facilities Management Inventories Audit

In response to your audit letter of June 13, 2003, the Facilities Management Department submits the following responses:

Issue # 1: Parts Inventory Records

Recommendation A: Include all unrecorded parts and supplies in the current inventory records.

Response: Concur — In process. All parts purchased by FMD will be included in the inventory within one day of receipt. All excess parts and supplies received from contractors working on Capital Improvement Projects will be recorded once FMD has received an accurate listing and value of the materials.

Target Completion Date: September 15, 2003

Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/ No additional cost associated with implementation.

Recommendation B: Record parts inventory activity timely.

Response: Concur — Completed. All new parts purchased by FMD are recorded within one working day of receipt.

Target Completion Date: June 15, 2003

Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/ No additional cost associated with implementation.

Recommendation C: Count all parts and supplies in the year-end physical inventory.

Response: Concur - Will implement with modifications – We have currently counted all parts in the warehouse locations and maintain the accuracy of inventory records through daily cycle counting, variance identification, root cause analysis and correction of errors. FMD has initiated the physical inventory of all trucks in accordance with year-end policies.

Target Completion Date: June 30, 2003

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Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/ No additional cost associated with implementation.

Issue # 2: Parts Inventory - Safeguard

Recommendation A: Segregate physical custody of inventory from responsibility for counting inventory.

Response: Implementation not currently possible - FMD does not have the resources available to provide for this type of separation of duties. FMD has however, established a new policy whereby supervisors will conduct random audits of the cycle count results and FMD will review all variances and take any necessary corrective actions.

Target Completion Date: Not applicable/ Completed Policy June 15, 2003

Benefits/Costs: Better accountability of inventory/The estimated cost of additional resources to fully implement the recommendation is \$80,000 annually.

Recommendation B: Segregate physical custody of inventory from inventory record keeping

Response: Concur - Completed. The responsibility for inventory adjustments within Maximo has been transferred from the Operations and Maintenance division to the Business Service division. While system limitations prevent the removal of authorizations without new system customization, we have established a monthly report showing inventory adjustments completed by date, type and responsible person initiating the adjustment. We believe that this accountability change and reporting tool resolves the issue.

Target Completion Date: June 18, 2003

Benefits/Costs: Better accountability of inventory/ No additional cost associated with implementation.

Recommendation C: Select cycle-count samples at random and provide the samples to the cycle-counters.

Response: Concur - In process. FMD will implement a process to generate random lists from Maximo of items to be cycle counted.

Target Completion Date: September 30, 2003.

Benefits/Costs: Better accountability of inventory/ No additional cost associated with implementation.

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Issue # 3: Part Inventory Valuation

Recommendation A: Include all parts and supplies in the inventory counts.

Response: Concur — In process. All parts purchased by FMD will be included in the inventory within one day of receipt. All excess parts and supplies received from contractors working on Capital Improvement Projects will be recorded once FMD has received an accurate listing and value of the materials.

Target Completion Date: September 15, 2003

Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/ No additional cost associated with implementation.

Recommendation B: Perform periodic analysis of variances between the moving average and standard costs of parts and adjust the standard cost accordingly.

Response: Concur – In process. FMD will develop the reporting mechanisms and processes to examine variances semi-annually and will update the Maximo standard costs in September and March of each year.

Target Completion Date: September 30, 2003

Benefits/Costs: More accurate valuation of inventory and parts used on work orders/ No additional cost associated with implementation.

Issue # 4: Surplus Office Furniture

Recommendation A: Prepare a formal inventory of all surplus furniture

Response: Concur — Completed. An inventory has been completed of all surplus furniture. The inventory will be used to identify furniture that can be used for current projects and all remaining balances will be sold through a revenue bid.

Target Completion Date: June 10, 2003

Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/ Inventory preparation resulted in the expenditure of \$3,800 to an outside vendor.

Recommendation B: Establish control over all additions and distributions of furniture inventory.

Response: Concur— In process. FMD does not have adequate resources to efficiently run an excess furniture program. An evaluation of current project needs is being completed and all remaining inventories will be sold through a revenue bid negating the establishment of any long-term controls.

Maricopa County
Facilities Management
Department
401 W. Jefferson Street
Phoenix, Arizona 85003
Phone: (602) 506-8227
Fax: (602) 506-4275

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Target Completion Date: September 30, 2003.

Benefits/Costs: Better accountability, procurement decisions and accuracy of inventory/
No additional cost associated with implementation.

Recommendation C: Record all additions and distributions of furniture inventory

Response: Concur - In process. FMD is not accepting any additional furniture and all
distributions will be tracked until the revenue bid is completed.

Target Completion Date: September 30, 2003.

Benefits/Costs: Better accountability and accuracy of inventory/ Additional costs, of
approximately \$3,000, to the outside vendor will be incurred to maintain the inventory.

Approved By:  6/19/03
Department Head/Elected Official Date

 6.18.03
Chief Officer Date

 6/19/03
County Administrative Officer Date