

City of Austin



**A Report to the
Austin City Council**

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**Office of the
City Auditor**

City Auditor
Corrie Stokes
CIA, CGAP, CFE

Deputy City Auditor
Jason Hadavi
CPA, CFE

AUDIT REPORT

Austin Water Central Stores Inventory Management Audit

June 2016



REPORT SUMMARY

Austin Water has established procedures to guide staff to track and safeguard inventory. Austin Water also reconciles book inventory records and actual quantity using cycle counts. However, the current practices at Austin Water do not fully ensure that its inventory records are accurate and inventory is safeguarded. As a result, adequate inventory may not be available to meet the needs of customers and resources may not be used as effectively as possible.

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GOVERNMENT AUDITING STANDARDS COMPLIANCE

We conducted this performance audit 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.

AUDIT TEAM

Neha Sharma, CPA, CISA, CIA, Acting Assistant City Auditor and Auditor-in-Charge
Cameron Lagrone, Auditor

Office of the City Auditor
phone: (512)974-2805
email: oca_auditor@austintexas.gov
website: <http://www.austintexas.gov/auditor>

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June 2016



Report Highlights

Why We Did This Audit

This audit was conducted as part of the Office of the City Auditor's FY 2016 Strategic Audit Plan risk assessment of Inventory Management in all City departments.

What We Recommend

The Director of Austin Water should:

- strengthen the inventory count process by:
 - a. Establishing policies and procedures for the inventory count
 - b. Establishing accountability for ensuring the process is followed
- ensure that central stores' staff comply with established policies and procedures; and
- develop a process for identification and disposal of idle and obsolete stock items.



For more information on this or any of our reports, email oca_auditor@austintexas.gov

AUSTIN WATER CENTRAL STORES INVENTORY MANAGEMENT AUDIT

BACKGROUND

Austin Water operates central stores located at the Webberville Business Service Center and Glen Bell Business Service Center. The primary purpose of these facilities is to provide supplies needed by work crews for maintenance and repair of the water and wastewater infrastructure managed by Austin Water. They also provide non-utility supplies to other City departments. Each central store maintains over 2,000 stock items. As of September 30, 2015 the inventory had a book value of \$2.27 million.

OBJECTIVE AND SCOPE

The objective of this audit was to determine whether Austin Water is managing inventory in their central stores effectively and efficiently. The scope of the audit included review of the current practices of Austin Water for inventory management.

WHAT WE FOUND

Austin Water has established procedures to guide staff about how to track and safeguard inventory. Additionally, Austin Water is reconciling book inventory records and actual quantity using cycle counts. However, current practices at Austin Water do not fully ensure that inventory is accurate and safeguarded. As a result, adequate inventory may not be available to meet the needs of customers and City resources may not be used effectively.

Process	Why it matters	What we found
Physical count of inventory	To ensure the accurate inventory records for operational decisions (such as items to order and quantity to order) and provide inventory balance for financial reporting.	Austin Water has adopted a cycle count of inventory method for the physical count of inventory; however the inventory count process has not been fully implemented to ensure accurate inventory records. There is an absence of comprehensive guidelines and inadequate supervision for the inventory count process.
Maintain the inventory levels	To ensure adequate inventory for operations and avoid over-stocking.	Central stores' staff does not fully follow established procedures of using the inventory reports to monitor inventory levels.
Authorization of Issue transactions	To prevent unauthorized purchases from the central stores.	Central stores' staff does not follow the established procedure of maintaining the list of City staff who are given authority to approve purchases from the central stores.
Idle and obsolete inventory	To ensure effective use of storeroom space and recovery of cost through salvage value.	Austin Water does not have a documented process to periodically identify and dispose of idle and obsolete stock items. There are about 525 stock items valued \$338,000 which have not been used at least for a year.

BACKGROUND

Austin Water operates two central stores located at the Webberville Business Service Center and Glen Bell Business Service Center. The primary purpose of these facilities is to provide supplies needed by work crews for maintenance and repair of the water and wastewater infrastructure that Austin Water manages. They also provides non-utility supplies to other City departments.

The inventory at the central stores includes supplies (e.g. brass fittings and pipes), tools (e.g. shovels and hammers), and consumables (e.g. batteries and safety equipment). Each central stores currently maintains over 2,000 inventory items. As of September 30, 2015, the inventory had a book value of \$2.27 million.

Austin Water uses AIMS, the City's financial system, to track central stores' inventory for operational decisions and to provide inventory balance for financial reporting. To ensure the accuracy of inventory records, book inventory records are reconciled to actual quantity.

There are two key methods for the physical count of inventory:

- Cycle Count: Partial inventory is counted periodically during the year.
- Wall-to-Wall Physical Count: 100% of inventory is counted at one point of time.

Austin Water is currently using the cycle count inventory method and is counting a selected group of items every month. The last wall-to-wall physical count was performed in Fiscal Year (FY) 2008.

OBJECTIVE, SCOPE, AND METHODOLOGY

The Austin Water Central Stores Inventory Management Audit was conducted as part of the Office of the City Auditor's (OCA) FY 2016 Strategic Audit Plan, as presented to the City Council Audit and Finance Committee. Austin Water was selected for this audit based on a risk assessment of inventory management in all City departments which identified a high value of inventory at Austin Water's central stores and a low accuracy rate for related physical inventory counts.

Objective

The objective of the audit was to determine whether Austin Water is managing inventory in their central stores effectively and efficiently.

Scope

The scope of the audit included review of the current practices of Austin Water for inventory management.

Methodology

To accomplish the audit objective, we performed the following steps:

- reviewed Austin Water's policies and procedures relating to inventory management;
- conducted interviews with staff at Austin Water;
- researched best practices for physical counts of inventory;
- evaluated controls in place for physical counts of inventory;
- analyzed documentation related to monthly cycle counts of inventory for FY 2014 and FY 2015;

- selected a judgmental sample of 30 stock items (15 from each warehouse) from the list of warehouse stock items and compared the book inventory records to actual quantity;
- counted the selected sample of items for both warehouses and evaluated the results of the count;
- verified authorization of issue requisitions for the selected sample; and
- evaluated the risk of fraud, waste, and abuse with regard to central stores operations.

WHAT WE FOUND

Austin Water has established procedures to guide staff to track and safeguard the inventory. Austin Water also reconciles the book inventory records and the actual quantity by following the cycle count method. However, current practices at Austin Water do not fully ensure that its inventory records are accurate and inventory is safeguarded as shown in Exhibit 1 below. As a result, adequate inventory may not be available to meet the needs of customers and City resources may not be used effectively.

EXHIBIT 1
Inventory Management

Process	Why it matters	What we found
Physical count of inventory	To ensure the accurate inventory records for operational decisions (such as items to order and quantity to order) and provide inventory balance for financial reporting.	Some components of a cycle count of inventory process have not been fully implemented. There has been an absence of comprehensive guidelines and inadequate supervision. See Finding 1.
Maintain the inventory levels	To ensure adequate inventory for operations and avoid over-stocking.	Central stores' staff does not fully follow established procedure of using the inventory reports to monitor inventory levels. See Finding 2
Authorization of Issue transactions	To prevent unauthorized purchases from the central stores.	Central stores' staff does not follow the established procedure of maintaining the list of City staff who are given authority to approve purchases from the central stores. See Finding 2
Idle and obsolete inventory	To ensure effective use of storeroom space and recovery of cost through salvage value.	Austin Water does not have a documented process to periodically identify and dispose of idle and obsolete stock items. See Finding 3

SOURCE: OCA analysis of the central warehouse inventory management process, May 2016

Finding 1: Austin Water has not fully implemented a physical count of inventory to ensure accurate inventory records.

Austin Water has not implemented the entire process of a physical count, recommended by best practices¹ as shown in Exhibit 2 below. In the Exhibit, the elements in bold indicate the areas where Austin Water needs to improve current practices for counting inventory. Implementation of the entire process for physically counting inventory is required to ensure accurate inventory records, to reduce cost, and to identify the opportunities for improvement through evaluation of results of inventory counts.

¹ Government Accountability Office Executive Guide: Best Practices in Achieving Consistent, Accurate Physical Counts of Inventory and Related Property

EXHIBIT 2
Physical Count of Inventory

Planning

1. **Select an approach to the count** : Austin Water performs monthly cycle count of inventory based on schedule created at start of fiscal year.
2. **Determine count frequency** : The department does not have criteria for determining how many times each stock group should be counted each year. We found that stock groups with high sales were counted less frequently than stock groups with low sales.
3. **Organize the count teams** : Austin Water central stores staff are organized into teams to perform cycle counts.

IMPACT To ensure effective use of time and resources, it is important to select appropriate stock items for cycle count. Counting stock groups with high sales more frequently ensures that the central stores will not have a shortage of high demand items.

Counting

1. **Complete inventory records** : Austin Water procedures establish a timeline for transactions to be recorded as inventory in accounting records before cycle count and all errors must be cleared within one week after the date the error is detected.
Staff informed us that receiving transactions may not be recorded in accounts records before cycle count. Also City departments may not correct transaction errors in a timely manner.
Of the 30 stock items tested by us, 8 stock items had incomplete inventory records. 3 of these 8 incomplete records had been in error status for more than one week.
2. **Count the inventory** : Austin Water creates count sheets with each item to be counted by warehouse staff.

IMPACT Incomplete accounting records cause variation between book inventory record and actual quantity.

Research and Adjustment

1. **Perform research of variations** : Austin Water has no documented threshold or procedure for staff to explain causes of variation between the book inventory records and actual quantity. Staff informed us that research and documentation of findings is required for all discrepancies above \$100.

We found that research was not conducted based on the dollar amount of the discrepancy and discrepancies above \$100 were not always explained. From a sample of discrepancy explanations, only 14 of 59 (24%) variances above \$100 were explained.
2. **Adjust the record** : Inventory records are adjusted without obtaining complete support for variances.

IMPACT Research helps staff identify the causes of variation between the book inventory record and actual quantity, and provides support for adjustments.

Evaluation of Results

1. **Determine the record accuracy rate** : The inventory record accuracy rate is computed for each inventory stock group counted during the month.
Our review of inventory accuracy rates for cycle counts in FY 2014 and FY 2015 indicated that the accuracy rate ranges between 51% to 91%. 18 of 30 (60%) items we tested had a book inventory record that matched with the actual quantity.
2. **Consider performance measures** : No performance measure or target accuracy rate has been established to evaluate the actual accuracy of the inventory count.
3. **Communicate the results of the count** : There is no process for communicating the results of cycle counts to management.

IMPACT Evaluating results of cycle counts provides information for measuring the effectiveness of the cycle count and helps management take corrective actions for improving the inventory process and systems.

SOURCE: OCA analysis of Austin Water cycle count of inventory process, May 2016

It appears that various components of the process for counting inventory are not implemented due to a number of factors, including the absence of comprehensive guidelines for the staff and inadequate supervision. Management indicated that there are currently no dedicated supervisory staff to oversee central stores' activities and informed us that they are in the process of hiring staff to take on that responsibility.

Finding 2: Central stores' staff is not fully complying with established policies and procedures designed to help maintain and safeguard an adequate level of inventory.

Austin Water has established policies and procedures for inventory management. These policies and procedures are intended to increase the efficiency of the inventory management process and to reduce the risk of loss of inventory through fraud, waste, and abuse. A Central stores' supervisor is assigned the responsibility for ensuring that central stores' staff complies with established requirements.

Based on our work, we noted that central stores' staff does not fully follow documented procedures, as detailed below:

Inventory reports to monitor inventory levels are not always utilized

- a. Items to order

What is required in the Manual	Why it matters	What we found
Review stock out report in Info View (AIMS Business Intelligence Tool)	To ensure adequate inventory for operations.	<ul style="list-style-type: none"> • Central stores' staff was ordering materials based on items identified as having a low quantity in stock during performance of daily duties. • During the course of audit warehouse staff was granted access to Info View and indicated that they are now ordering materials based on review of the out of stock report.

b. Quantity to order

What is required in the Manual	Why it matters	What we found
Review transaction history to calculate a 3 month supply and confirm stock level through the stock out report in Info View and physical inspection.	To ensure adequate inventory for operations and avoid over-stocking.	<ul style="list-style-type: none"> • The 3 month historical usage is not always computed. Invariably the quantity ordered is based on a special request from the department or on estimated consumption without considering past usage. • In our testing of 10 items, we have identified 2 items which were "over-ordered" beyond their estimated 3-month usage. Staff indicated that these items were over-ordered due to special requests from customers.

An Authorized Signature List² for purchases from the Central Stores is not maintained

What is required in the Manual	Why it matters	What we found
A list of authorized signatories for every department is maintained and updated upon any changes.	There is a risk that a city staff could charge items to a department account without being an authorized signatory or even a current city employee.	<ul style="list-style-type: none"> • The authorized signature list has not been updated since 2011. • In 21 of the 30 (70%) selected purchases, the authorizers of the requisitions were not included in the authorized signature list. • There is no documented requirement for central stores staff to verify the signature on authorized signature list. • Per current practice, central stores' staff issue materials to city employees who come in dressed or identified as supervisors.

Based on our interviews, management cited existing vacant positions at the central stores as a reason for not complying with the established procedures. Austin Water management indicated that they have been working on filling the vacant positions at the central stores.

Finding 3: Austin Water does not have a process to periodically identify and dispose of idle and obsolete stock items in their central stores, which may result in not utilizing City resources effectively.

The central stores have 525 stock items (valued at \$338,000) which are idle³. These 525 stock items include 304 stock items (valued at \$235,000) for Webberville Business Service Center and 221 stock items (valued at \$103,000) for Glen Bell Business Service Center.

These idle stock items include items for which the last issue date was in FY 2008. The number of idle stock items that are obsolete⁴ is unknown. Austin Water staff informed us that the several items were identified as obsolete in FY 2010, however these items are still occupying space at the central stores.

² A list of City staff who has been authorized to purchase stock items from the central stores.

³ Idle stock items are items that have experienced no usage during preceding 12 month period.

⁴ Obsolete stocks are stock items that no longer meet the Utility specifications or requirements.

Idle or obsolete inventory indicates a waste of resources including; 1) funds that are spent for inventory that is not needed, 2) no recovery of cost through salvage value and 3) space being used to store unneeded items. We found that there is no documented process to periodically identify and dispose of the idle and/or obsolete inventory.

RECOMMENDATIONS

- 1. The Director of Austin Water should strengthen the inventory count process by:**
 - **establishing policies and procedures for the inventory count and**
 - **establishing accountability for ensuring the process is followed**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

- 2. The Director of Austin Water should ensure that central stores' staff comply with established policies and procedures for inventory management.**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

- 3. The Director of Austin Water should develop a process for identification and disposal of idle and obsolete stock items.**

MANAGEMENT RESPONSE: CONCUR. Refer to Appendix A for management response and action plan.

MANAGEMENT RESPONSE



MEMORANDUM

To: Corrie Stokes, City Auditor
From: Greg Meszaros, Director, Austin Water 
Date: June 15, 2016
Subject: Response to Audit Findings – Austin Water Central Stores Inventory Management Audit

The Central Stores Inventory Management Audit had three findings. Austin Water (AW) concurs with each of the findings and recommendations. We have provided a more detailed response to each of the findings below.

Finding1: Austin Water has not fully implemented a physical count of inventory to ensure accurate inventory records.

Management Response: Concur

Austin Water management will review inventory management best practices for physical counts of inventory and ensure improvements in current practices. A thorough analysis of stock items sales will be conducted to ensure that the highest dollar sales are counted more frequently than lower dollar sales items. AW will work to establish specific timelines for inventory cycle counts and the associated research and corrections to inventory. AW will also establish accountability for evaluation of the results of each inventory cycle count and communicating those results to management.

Austin Water has already created an inventory management project team that is working to implement the findings of the audit. We reviewed the preliminary findings and discussed strategies to implement the recommendations. One action was to review stock items with the highest dollar sales and ask the Controller's Office to adjust the most recent June cycle count to include these stock items.

Additionally, earlier this year, AW created a new division called Supply Chain Management. This division is responsible for purchasing, central stores, and fleet functions within AW. This new division manager will focus exclusively on these important and critical functions. Previously, these functions were assigned to other managers that didn't always have sufficient time and focus on central stores and inventory management. We are currently in the process of filling this position and once a candidate is selected a key focus will be the implementation of inventory best management practices and the audit recommendations.

Finding 2: Central stores staff is not fully complying with established policies and procedures designed to help maintain and safeguard an adequate level of inventory.

Management Response: Concur

Austin Water currently has policies and procedures for inventory management. Based on the recommendations of the audit, AW will fully review and improve those policies and procedures in accordance with recommended best practices. AW will also review its management processes to strengthen accountability for those procedures. AW will strengthen the utilization of current financial system inventory reports to improve inventory management practices. Additionally, AW will assess our current internal control for inventory management.

Finding 3: The central stores do not have a process to periodically identify idle and obsolete stock items, which may result in not utilizing City resources effectively.

Management Response: Concur

Austin Water will develop policies and procedures to periodically identify idle and obsolete stock items. AW will ensure compliance with best practice methods for managing idle or obsolete stock items to allow for effective use of central stores space and explore salvage values of any extra stock items.

Austin Water is committed to strengthen and improve its inventory management policies and procedures to ensure consistency with best practices. Austin Water appreciates the work of the Office of the City Auditor to provide recommendations on our inventory management practices.

If you have any questions or need additional information please contact me.

cc: Robert Goode P.E., Assistant City Manager

Austin Water Central Stores Inventory Management Audit – Action Plan

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
<p>1. The Director of Austin Water should strengthen the inventory count process by:</p> <ul style="list-style-type: none"> • Establishing policies and procedures for the inventory count • Establishing accountability for ensuring the process is followed 	<p>Concur</p> <ul style="list-style-type: none"> • Director will review inventory management best practices and ensure improvements to inventory count process. Will evaluate stock item dollar sales volumes to ensure highest volume dollar sales items are counted more frequently. Will work to establish specific policies and procedures for specific timelines for counts, research and corrections to inventory. • Assistant Director of Financial Services will continue participation on inventory management project team to discuss strategies and ensure implementation of audit recommendations. 	<p>Currently underway.</p>	<p>Expected implementation date: March 31, 2017</p>
<p>2. The Director of Austin Water should ensure that central stores staff comply with established policies and procedures for inventory management.</p>	<p>Concur</p> <ul style="list-style-type: none"> • Assistant Director of Financial Services will continue efforts to complete the hiring process for division manager over Central Stores. • As inventory management policies and procedures are reviewed and revised to best practices, the Assistant Director of Financial Services will establish review procedures to ensure accountability. More specific requirements for inventory management will 	<p>Underway</p>	<p>Expected implementation date: December 31, 2016</p>

APPENDIX A

Recommendation	Concurrence and Proposed Strategies for Implementation	Status of Strategies	Proposed Implementation Date
	be included in SSPRs. <ul style="list-style-type: none"> Will review and assess best practice inventory management internal controls policies and procedures. 		
3. The Director of Austin Water should develop a process for identification and disposal of idle and obsolete stock items.	Concur <ul style="list-style-type: none"> Assistant Director of Financial Services will develop best practice policies and procedures to periodically identify idle and obsolete stock items. Any current obsolete or idle stock items will be reviewed, written off, and salvage value explored to ensure effective use of central stores stock space. 	Underway	Expected implementation date: December 31, 2016