CITY OF TALLAHASSEE
OFFICE OF THE CITY AUDITOR

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City Auditor

HIGHLIGHTS

Highlights of City Auditor Report #1014, a report to the City Commission and City management

MUNICIPAL SUPPLY CENTER TRANSITION TO ELECTRIC-UTILITY SUPPLY CENTER

Procurement, Accounting Services, and Electric worked together to comply with applicable City policies and procedures during the transition of the inventory warehouse from Department of Management and Administration to Electric Utility.

WHY THIS AUDIT WAS CONDUCTED

The City is transferring the Municipal Supply Center (MSC) warehouse, with an inventory value of approximately $10.3 million, from Department of Management and Administration (DMA) Procurement Division to the Electric Utility. After its transfer, the warehouse will support Electric Utility and Underground Utility.

Our objectives for this audit were to observe the warehouse transition process to determine compliance with City policies and procedures throughout the transition process, ensure appropriate inventory valuation, and ensure proper accounting for inventories.

WHAT WE RECOMMENDED

The Electric USC will be making the following improvements to:

- Complete the reconciliation between the physical inventory count and the accounting inventory value;

- Improve how inventory is maintained in the warehouse;

- Better account for warehouse overhead;

- More efficiently and effectively utilize PeopleSoft to account for inventory;

- Obtain needed warehouse and office equipment; and

- Improve the physical security of City assets stored at the warehouse.

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http://www.talgov.com/auditing/auditreports.cfm

For more information, contact us by e-mail at
auditors@talgov.com or by telephone at 850/891-8397.

WHAT WE CONCLUDED

During the transition, Procurement, Accounting Services, and Electric have worked together to comply with applicable City policies and procedures and continue to consider the policies as additional work is completed related to the transition.

We can provide assurances that the following has been accomplished:

- Written procedures to ensure compliance with City policies and procedures were developed prior to the physical inventory count and were discussed with individuals taking the inventory count;

- The physical inventory count was conducted in an orderly, professional manner with supervisory staff in attendance during the count;

- A diligent attempt was made to account for all items located in the warehouse and if obsolete items were identified, those items were marked for disposal through appropriate surplus procedures; and

- A reconciliation between the physical count and the inventory recorded in PeopleSoft is in progress to ensure a proper accounting for inventory and an appropriate inventory valuation.

During our observation of the warehouse transition process, there were some differences discovered between the physical count and the inventory value recorded in the accounting records that need to be resolved to establish an agreed-upon beginning inventory value for the Electric Utility Supply Center (USC) as of October 1, 2009. Additionally, there are some operational issues that Electric staff is addressing to implement procedures and processes to improve the accounting for and safeguarding of the warehouse inventory.

We would like to thank DMA and the Electric Utility for requesting the Office of the City Auditor to participate in this project by providing assurance services relating to the transition of inventory.

_____Office of the City Auditor

Audit of the Municipal Supply Center Transition Project

As of March 1, 2010

Sam M. McCall, Ph.D, CPA, CGFM, CIA, CGAP
City Auditor

Municipal Supply Center
Transition to Electric–Utility Supply Center

Summary

The Office of the City Auditor is providing assurance services to assist management throughout the transition of the Municipal Supply Center (MSC) warehouse from Department of Management and Administration (DMA) Procurement, to the Electric Utility. This transition is being undertaken to more closely align the warehouse inventory with the functions most likely to use the products housed as inventory in the warehouse. The warehouse, after its transfer, will support Electric Utility and Underground Utility. Some general supply items will be maintained in the warehouse for use by Electric Utility and Underground Utility and those general items may be issued to any department as needed. At October 1, 2009, the MSC inventory was valued at approximately $10.3 million, 91% of the total value of inventory items warehoused by the City and recorded in PeopleSoft financial records.

Activities related to the transition occurring to assist in the process of Electric assuming the responsibility for the MSC warehouse inventory included:

- A physical inventory was conducted at the MSC starting on October 2, 2009.

- On October 17, 2009, an initial reconciliation was performed by Electric Utility. This initial reconciliation indicated that the value of the inventory recorded in PeopleSoft financials was approximately $400,000 greater than the value of inventory recorded in the PeopleSoft inventory module at MSC (i.e., after the physical inventory count). This reconciliation is being performed to arrive at a final listing of inventory and value that is to be accepted by Electric as transferred from DMA.

- Inventory was transferred from Fund 725, Purchasing Fund, to Fund 426, Electric Warehouse Fund, by Accounting Services.

- Liaisons were established in Electric Utility and Underground Utility to assist in processing warehouse transactions.

We can provide assurances that the following has been accomplished:

- Written procedures to ensure compliance with City policies and procedures were developed prior to the physical inventory count and were discussed with individuals taking the inventory count;

- The physical inventory count was conducted in an orderly, professional manner with supervisory staff in attendance during the count;

- A diligent attempt was made to account for all items located in the warehouse and if obsolete items were identified, those items were marked for disposal through appropriate surplus procedures; and

- A reconciliation between the physical count and the inventory recorded in PeopleSoft is in progress to ensure a proper accounting for inventory and an appropriate inventory valuation.

Methods to properly account for and safeguard warehouse inventory continue to be put into place at the Electric-Utility Supply Center (USC) as staff follows through with improvements and changes to:

- Improve how inventory is maintained in the warehouse;

- Better account for warehouse overhead;

- More efficiently and effectively utilize PeopleSoft to account for inventory;

- Obtain needed warehouse and office equipment; and

- Improve the physical security of City assets stored at the warehouse.

Accounting Services continues to work to complete the reconciliation between the physical inventory count and the inventory value recorded in the accounting records and establish an agreed-upon beginning inventory value for USC. Accounting Services anticipates the transition reconciliation will be completed by the end of May 2010.

Scope, Objectives, and Methodology

Our objectives for this audit were to observe the warehouse transition process to:

- Determine compliance with City policies and procedures throughout the transition process;

- Ensure appropriate inventory valuation; and

- Ensure proper accounting for inventories.

We performed procedures sufficient to achieve the objectives including interviewing key staff in Electric Utilities, reviewing established policies and procedures, observing inventory activities, and reviewing the reconciliation process.

We conducted this project in accordance with the International Standards for the Professional Practice of Internal Auditing and 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.

Background

City Administrative Policy and Procedure (APP) #613 establishes policy, procedures, and criteria for the establishment of inventories of parts and supplies. APP #613 provides that under specific circumstances City departments may establish and maintain departmental inventories separate from the City's central stores, such as the inventory established at MSC. The inventory items warehoused by the City and recorded in PeopleSoft at October 1, 2009, were valued at $11,231,489, with 91% of the total value located at MSC.

Table 1
Warehouse Inventory Value
at October 1, 2009

Warehouse	Total Value October 1, 2009	Percent of Value
Municipal Supply Center (COTMS)	$ 10,293,414	91%
Water (COTWA)	$ 550,651	5%
Public Works Warehouses (COTPW)	$ 187,544	2%
Electric Transmission and Distribution Warehouse (COTEL)	$ 138,145	1%
Gas Meter Warehouse (COTGS)	$ 61,735	1%
Total Inventories	**$ 11,231,489**	**100**%

MSC was previously organizationally located within the DMA Procurement Section, but has now been reassigned by City management to Electric Utility. Electric Utility assumed the responsibility of managing the transition of MSC and assigned the responsibility to the Production Management section. When the transition is complete, the warehouse will house inventory for the Electric Utility and Underground Utility departments. Some general supply items will be maintained in the warehouse for Electric Utility and Underground Utility and those general items may be issued to any department as needed. Electric additionally has the responsibility for the following other City warehouses:

- Hopkins Generating Station,

- Purdom Power Plant, and

- Electric Transmission and Distribution Warehouse (COTEL).

In the transition of the MSC warehouse, the objectives of Electric Utility included conducting a safe and orderly complete physical count, consistent with Generally Accepted Accounting Practices (GAAP), of the items located at MSC, prior to the transition of the inventory function to Electric. The count was conducted to:

- Ensure the inventory items and quantities recorded in PeopleSoft accurately reflected the items stored at the MSC facility;

- Establish the inventory value of the items being transferred from MSC to the Electric-USC;

- Ensure the availability of inventory to meet operational needs; and
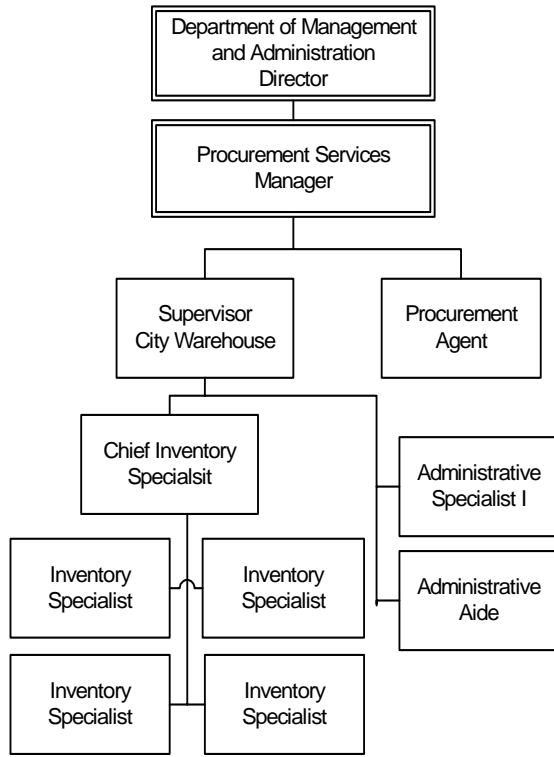
- Identify obsolete inventory.

In anticipation of conducting a complete physical inventory, Electric Utility:

- Maintained documentation to provide accountability throughout the inventory process;

- Adopted written procedures for the inventory count;

- Established a date for cut-off of all inventory receipts and issues to ensure that all items in the warehouse were inventory items to be counted. If items were to remain in the warehouse that were not inventory items, those items were to be identified appropriately;

- Enlisted knowledgeable staff to assist in the physical inventory count and met with and provided instructions to the staff prior to the day of the inventory count;

  (See pictures #1 and #2, Appendix B.)

- Considered segregation of duties among staff and inventory count teams were set up with individuals from different departments as appropriate to limit conflicting duties; and

- Prepared numbered, blind inventory count sheets (i.e., inventory sheets that did not contain an inventory quantity) to be used by inventory counters.

Warehouse Organizational Structure
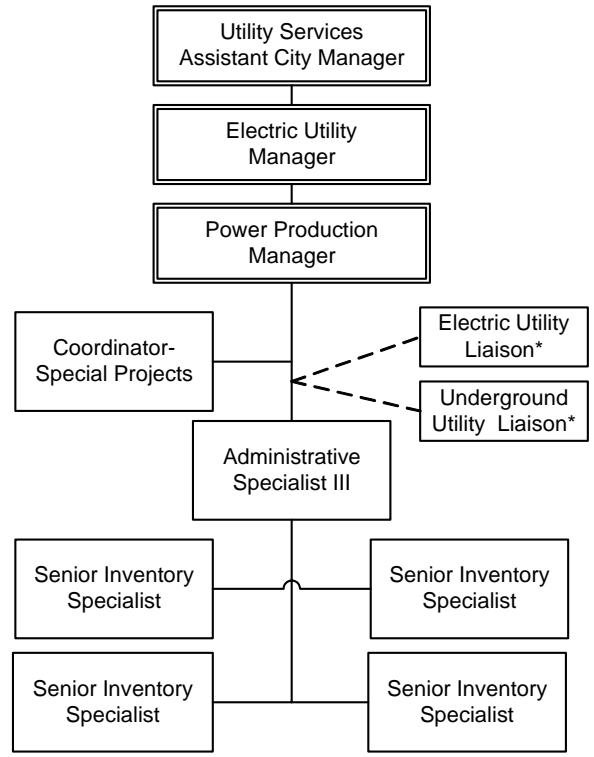
As part of the overall transition process Electric Utility, Production Management, designated the Coordinator-Special Projects, to oversee the transition of the MSC warehouse to the Electric-Utility Supply Center (USC) and manage the newly established warehouse. The following organizational charts depict the warehouse organization before and after the transition to Electric.

**Table 2 – Organizational Chart
Municipal Supply Center
Prior to Transition to Electric**

```
┌─────────────────────────┐
│ Department of Management│
│     and Administration  │
│         Director        │
└─────────────────────────┘
┌─────────────────────────┐
│  Procurement Services   │
│        Manager          │
└─────────────────────────┘
     ┌──────────────┬──────────────┐
┌──────────┐            ┌──────────┐
│Supervisor│            │Procurement│
│City      │            │  Agent    │
│Warehouse │            └──────────┘
└──────────┘
┌──────────────┐         ┌──────────────┐
│Chief Inventory│        │Administrative│
│  Specialsit   │        │ Specialist I │
└──────────────┘         └──────────────┘
┌─────────┐ ┌─────────┐  ┌──────────────┐
│Inventory│ │Inventory│  │Administrative│
│Specialist│ │Specialist│ │    Aide      │
└─────────┘ └─────────┘  └──────────────┘
┌─────────┐ ┌─────────┐
│Inventory│ │Inventory│
│Specialist│ │Specialist│
└─────────┘ └─────────┘
```

**Table 3 – Organizational Chart
Proposed Warehouse Organization
Electric – Utility Supply Center**

```
┌─────────────────────────┐
│    Utility Services     │
│ Assistant City Manager  │
└─────────────────────────┘
┌─────────────────────────┐
│    Electric Utility     │
│        Manager          │
└─────────────────────────┘
┌─────────────────────────┐
│   Power Production       │
│       Manager            │
└─────────────────────────┘
┌──────────────┐              ┌──────────────┐
│Coordinator-  │ ─ ─ ─ ─ ─ ─  │Electric Utility│
│Special Projects│            │  Liaison*     │
└──────────────┘              └──────────────┘
                              ┌──────────────┐
┌──────────────┐              │Underground   │
│Administrative│              │Utility Liaison*│
│Specialist III│              └──────────────┘
└──────────────┘
┌──────────────┐         ┌──────────────┐
│Senior Inventory│       │Senior Inventory│
│  Specialist    │       │  Specialist    │
└──────────────┘         └──────────────┘
┌──────────────┐         ┌──────────────┐
│Senior Inventory│       │Senior Inventory│
│  Specialist    │       │  Specialist    │
└──────────────┘         └──────────────┘
```

* Department Liaison assignments are not USC staff, but Electric Utility and Underground Utility staff assigned to assist with USC inventory transactions.

A change in the structure of the warehouse organization is that there will now be two "department liaisons" with which the warehouse staff will interact directly on issues related to adding and deleting stocked items, forecasting operational needs, and resolving issues as required. The department liaisons will be organizationally located with Electric Utility and Underground Utility staff and will provide information and communication between the two departments and the warehouse.

An additional change includes differences in the manner in which contracts are obtained and maintained. Rather than being the responsibility of Procurement Services, it is now the responsibility of the USC staff to maintain active contracts for USC inventory items. This responsibility will include both the preparation and maintenance of the contracts.

Status and Recommendations

Reconciliation of Physical Inventory to Accounting Records (PeopleSoft)

Accounting Services, Procurement Services, and the satellite warehouse staff from several different departments all work together to ensure fiscal responsibility and provide goods and customer service to the City of Tallahassee staff. Procurement and Accounting Services have been active in the transition process of MSC to USC and Accounting Services is in the process of completing a reconciliation between a physical

inventory count and the inventory recorded in PeopleSoft to arrive at a final listing of inventory and value that is to be accepted by Electric as transferred from DMA.

In January 2010 Electric Utility provided the Office of the City Auditor and Accounting Services with an initial reconciliation between the physical inventory report and the inventory value recorded in PeopleSoft at October 17, 2009. This initial reconciliation indicated differences valued at approximately $400,000. As of April 2010, the reconciliation had not been finalized.

We recommend that efforts continue to complete the inventory reconciliation to identify and resolve any outstanding issues and establish an agreed-upon beginning inventory value for the Electric-USC. Any necessary adjusting entries should be documented along with documentation supporting the necessity for the adjustments. Electric Utility should review and agree with the reconciliation and adjusting entry documentation prior to adjusting entries being finalized.

Physical Inventory

As described in the background section, a physical inventory has been taken of the items in the MSC warehouse. Several issues were noted that caused difficulty in taking the physical inventory, identifying individual items on the warehouse shelves, and recording count results and changes to inventory records.

- Item locations recorded in PeopleSoft were not always accurate and some items recorded in PeopleSoft were not on the shelves; *(See picture #4, Appendix B.)*

- Some similar items in inventory have been assigned the same item numbers in PeopleSoft in some instances. For example, per the Coordinator-Special Projects, some pipe fittings were included in inventory with a single item number even though the fittings had different specifications when ordered, and may have

been made of different materials (i.e., brass, PVC, etc);

- Obsolete items were sometimes inappropriately located on warehouse shelves, or in the warehouse yard, along with active inventory items, and were not always included in the inventory listing. For example, a large number of unusable six volt batteries were located on the inventory shelves, but were not in the inventory listing. Such items had to be entered into inventory, then transferred to surplus and deleted from the inventory. Any obsolete items identified during the physical inventory are in the process of being transferred out of the warehouse to surplus;

- Some items that are of no use independently, but are always used in tandem with other items, are being recorded in PeopleSoft and stored in the warehouse separately, rather than as a single functional unit. It is the goal of the warehouse staff to identify these types of items so they can be bundled into kits, either by the vendor, or upon receipt at the warehouse. As an example, the Coordinator-Special Projects identified a type of bracket that is used in sets of six, with a combination of nuts and bolts necessary to secure the brackets to a foundation. It would be helpful to both warehouse staff and inventory users to have all necessary parts bundled into one kit in inventory.

- There were two limitations in the PeopleSoft inventory module that increased the length of time to complete the inventory, thereby increasing the overall inventory costs.

  o It was noted during the physical inventory that data entry was delayed as only one individual could input new locations into the system at a time, and

o   Data entry could not add new items that were not in the system until after the inventory processes were run in PeopleSoft. This could not be done until all counts were complete.

(See picture #6, Appendix B.)

We recommend that USC staff, while addressing the issues noted above, continue its efforts to organize, record, and maintain warehouse inventory items to facilitate future physical inventory counts at USC.

Warehouse Overhead

Warehouse overhead has previously been accounted for through the City's cost allocation process, although currently a change to a mark-up system is planned. Electric will conduct periodic analyses of overhead cost and will adjust the mark-up rate as necessary.

As implementation of the mark-up system to account for overhead progresses, Accounting Services should be aware of the results of the new cost recovery method and review accounting entries to ensure that inventory warehouse costs are being appropriately recovered.

We recommend that USC staff work closely with Accounting Services to ensure the USC warehouse costs are recovered as intended.

PeopleSoft System

Warehouse employees responsible for the newly established USC recently attended PeopleSoft Inventory Module training to assist them in accurately and efficiently maintaining inventory records for USC. Areas in which concerns have been noted include:

*   Per the warehouse staff, replenishing inventory items in PeopleSoft is "cumbersome" and a time consuming process as currently implemented. Staff is attempting to learn more about the replenishment process to take advantage of available features and make the process as efficient and effective as possible.

*   A variation allowance was set up in PeopleSoft prior to the October 2009 inventory, for 5% or greater than $10 in the inventory system such that variances less than 5% or $10 do not show up on inventory reports. This will have some effect on inventory variance reports, but it is anticipated the resulting variances will be small as most inventory items are valued at greater than $10. The variation allowance will be turned off to eliminate future variances.

*   Consideration of changes to a more accurate "units of measure" method to better account for inventory items. For example, cable may be better accounted for by the foot, rather than by weight or spool. Consideration of units of measure will be an ongoing activity and changes will be made in PeopleSoft as improvements are made in this area.

*   Available PeopleSoft inventory reports currently cut off the item description line, making it difficult for users to determine if they are counting/issuing the correct items. USC staff is working to redesign the reports to display complete item description.

*   There were no pre-designed inventory reports available for distribution to departments, although progress has been made in this area and these reports will soon be available through PeopleSoft. These reports will keep Electric Utility and Underground Utility informed on a monthly basis of inventory that is being requested and used. Data will be detailed to include the identity of the section and employee requesting the inventory items.

USC staff should continue to explore ways to more accurately and efficiently utilize the PeopleSoft inventory system to better account for USC warehouse inventory.

Warehouse and Office Equipment

The USC staff is continuing to consider needs related to the physical operation of the warehouse. Several issues have been identified and plans are in progress to obtain equipment to most efficiently and effectively handle the processing (i.e., receiving, issuing, maintaining inventory items). These needs include:

- The purchase of bar coding equipment to assist in labeling and identifying inventory items has been researched and the purchase of this equipment is being considered. An issue identified in the research of the bar coding equipment is that there is a third party application that will be needed to use the equipment. Additionally, after the third party application is purchased, the PeopleSoft team will have to perform testing prior to the application's installation and use. Further research is needed to ensure that the equipment purchased is the most compatible with PeopleSoft systems currently in place at the warehouse.

- Scales are being purchased to allow warehouse to weigh large items for which the unit of measure is pounds and ounces. Additionally, equipment is being considered that will electronically measure cable. Both of these items will assist warehouse staff to more accurately issue and maintain inventory stock.

- Reconfiguration of office space is underway and low-profile cubicles are being purchased for the warehouse staff assigned to receive and issue inventory items.

We recommend that USC staff continue to investigate and determine the most efficient and effective equipment to best manage warehouse operations.

Physical Security

Upgrades to the physical security of the warehouse facility are being undertaken in several areas.

- The Tallahassee Police Department (TPD) reviewed the security of the warehouse facility and made recommendations for security improvements.

- A private security vendor has made many security improvements including: installing card access, adding cameras as needed, relocating photo beams, and addressing security issues pointed out in the TPD security report.

- Garage doors to the warehouse have been repaired to allow security sensors to be activated.

- Security lighting has been installed.

- The receiving area is being segregated from the areas from which items are issued to users.

- Scrap bins have been relocated to limit access to the warehouse inventory yard.

- The area designated to house surplus items has been fenced and access changed to eliminate access through the warehouse area.

  See Appendix B, picture #5.

- The fire protection system has been inspected and repairs made as needed.

Conclusion

Progress in the warehouse transition from Procurement to Electric continues and efforts are being made to resolve outstanding issues. During the transition, Procurement, Accounting Services, and Electric have worked together to comply with applicable City policies and procedures and continue to consider the policies as additional work is completed related to the transition.

An appropriate inventory valuation had not been determined at April 1, 2010; however, Accounting Services continues to work to complete the reconciliation between the physical inventory count and the inventory value recorded in the accounting records. Accounting Services anticipates that the transition reconciliation will be completed by the end of May 2010.

Methods to properly account for and safeguard warehouse inventory continue to be put into place by USC as additional issues, as discussed above, are resolved and corrected. Our office worked with management to identify action steps to address and complete outstanding issues. These steps are provided in Management's Action Plan in Appendix A.

The Office of the City Auditor will review the progress of this project in September 2010.

We would like to thank DMA and the Electric Utility for requesting the Office of the City Auditor to participate in this project by providing assurance services relating to the transition of inventory.

Appointed Official's Response

City Manager Response:

We appreciate the hard work conducted by the City's Auditor's Office, the Electric Department and the Department of Management and Administration as related to this audit report. The transition of the management of the supply center from Procurement Services to the Electric Utility will provide a more direct approach for the management of the City's utility related inventory. The action plans developed as a result of this audit, shall assist to ensure that adequate procedures and proper inventory accounting and warehouse practices are in place to increase the efficiency and effectiveness of this program. I want to thank the City's Auditor Office for assisting management throughout the transition.

Appendix A – Management's Action Plan

Action Steps	Responsible Employee(s)	Target Date
Appropriate Inventory Valuation		
A. Reconciliation of Physical Inventory to Accounting Records		
1. Complete the reconciliation of the physical inventory count to the inventory value recorded in PeopleSoft and identify and resolve any outstanding issues. Document any adjustments to inventory including the reasons for the adjustments. Obtain concurrence and acceptance from Electric for the reconciliation, adjustments, and reasons for adjustments.	Rick Feldman - Accounting Diane Blanton – Electric Utility	5/31/2010
2. Establish a beginning balance for transition to Electric.	Rick Feldman	5/31/2010
Accounting for Inventories		
B. Physical Inventory		
1. Ensure that inventory item locations questioned during the transition physical inventory cycle count are corrected and are sufficient to locate the items in the warehouse.	Diane Blanton	6/30/2010
2. a. Develop a process for assignment of unique identification numbers to all inventoried items, including those of a similar nature. b. Assign unique item numbers for similar items that were identified during the transfer cycle count.	Diane Blanton	a. 6/30/2010 b. 9/30/2010
3. a. Remove from inventory and surplus all items that were identified during the transition cycle count as obsolete. b. Establish a process for identification of obsolete items to ensure that items are reviewed periodically by the user departments. c. Develop a process to ensure removal of items identified as obsolete from the warehouse inventory.	Diane Blanton	a. 6/30/2010 b. 9/30/2010 c. 9/30/2010
4. a. Develop a process to identify items that cannot be used independently of others. b. Organize and record the dependent items as "kits" to ensure users receive the proper equipment when the items are issued.	Diane Blanton	a. 630/2010 b. Sixty days after user departments' identification of kit compositions.
5. Investigate the issue of recording inventory counts and changes to inventory to improve the entry of those counts into the system in a more efficient and timely manner.	Diane Blanton	9/30/2010
C. Warehouse Overhead		
1. Continue efforts to allow and account for warehouse operations through a mark-up process. The warehouse operations will no longer be a part of the City's cost allocation process.	Diane Blanton	4/30/2010

Action Steps	Responsible Employee(s)	Target Date
D: PeopleSoft		
1. Continue efforts to make the replenishment process more efficient.	Diane Blanton	4/30/2010
2. Develop a process to review units of measure assigned to various inventory items in PeopleSoft and determine the most accurate methods for items in question.	Diane Blanton	9/30/2010
3. Explore methods to include a complete description of inventory items in inventory reports to allow accurate identification of items by warehouse staff and/or inventory counters.	Toni Clinton - Procurement	9/30/2010
4. Continue efforts to more efficiently produce monthly inventory reports through PeopleSoft for Electric Utility and Underground Utility to allow these departments to timely review inventory use.	Diane Blanton	4/1/2010- Completed
Transition of Warehouse to Electric		
E. Warehouse and Office Equipment		
1. Continue to investigate and determine the most efficient and effective equipment to best manage warehouse operations.	Diane Blanton	9/30/2010
F: Physical Security		
1. Develop a process to review the security measures in place at the warehouse to safeguard the city's assets maintained by Electric at the Utility Supply Center.	Diane Blanton	9/30/2010

Appendix B
Warehouse Inventory Observations

(1) Instructions were provided to staff assigned the responsibility of counting inventory prior to the start of the physical inventory count on October 2, 2009.

(4) Inventory items were not always physically located where the inventory records indicated they would be located.
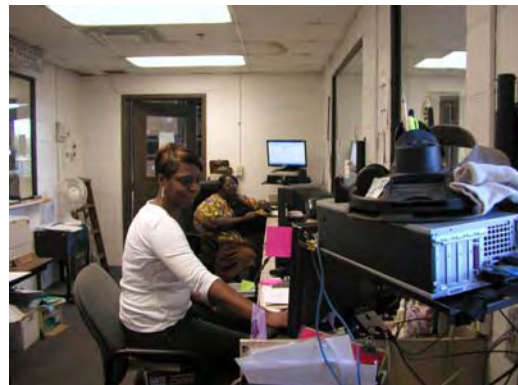

(2) Individuals assigned to count inventory, counted items located on the warehouse shelves and also in the warehouse yard

(5) The entrance to the area housing surplus items has been relocated to eliminate access through the warehouse yard.

(3) Some inventory items located on the warehouse shelves or in the warehouse yard appeared to be out-of-date, or obsolete items.

(6) Data entry was delayed as only one individual could input new locations into the system at a time. New item numbers, etc., could not be entered into the system until the count was complete.