

# **COUNTY OF PLACER**

OFFICE OF AUDITOR-CONTROLLER

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Mr. Ken Grehm, Director Placer County Public Works Department 3091 County Center Drive, Suite 220 Auburn, CA 95603

Re: Year-End Inventory Count Review

Dear Mr. Grehm:

The Internal Audit Division of the Auditor-Controller's Office performed a review of the Fleet Services Division (Division) year-end inventory count made by the Public Works Department (Department) as of May 16, 2011 (Auburn) and May 23, 2011 (Tahoe). The objectives of our review were to obtain an understanding of the entity's internal control over financial reporting, assess the control risks, ensure inventory count is accurate and complete, and make recommendations for improvement.

Based on our review, which consisted of inquiries of Fleet Services staff regarding current processes, procedures employed by the Department, and physical inspection of inventory, we feel the current internal controls over financial reporting are lacking sufficient checks and balances to ensure the safeguarding of assets. Based on the sample selected, our summary of findings and recommendations are as follows.

### **Counting Procedures**

During our inventory observation procedures, we noted inventory counters for the Auburn garage continue to miscount items throughout the process causing ending inventory counts to be questioned for accuracy and validity. We found 20% of the sample we selected was incorrectly counted which gives us minimal assurance that numbers reported are reliable.

We recommend the Division properly train employees on the importance of meticulously counting all items in inventory to ensure an irrefutable ending inventory number.

## Department Response:

Currently, we have two people participating in the count of inventory. One physically does the count and inputs the number electronically while the other maintains a written count. Later these two counts are reconciled and any discrepancies are recounted to determine the correct

count. In Tahoe, I believe, the sample taken by the Auditor's office showed 100% correlation with our determined count. In Auburn, the Auditors check was performed after the initial count but before our reconciliation process was completed. I would anticipate that the error rate would have been less than 20% (based on our Tahoe experience) if we had completed our process.

Regardless, counts should be accurate before the process is complete. We will continue to work with personnel performing counts to improve accuracy with the intent to get closer to the error rate experienced at Tahoe.

#### **Discrepancy Report**

The Discrepancy Report for Fleet inventory continues to identify excessive errors, which is of a concern because the variations remain significant. The discrepancies between the quantities recorded in the perpetual inventory system compared to the actual physical count performed by Fleet staff are a total of over 6,000 items with a total value of nearly \$47k for both Auburn and Tahoe.

It is important to note that this is the third consecutive year in which we have performed an inventory observation for Fleet. For fiscal years ended 2009 and 2010 respectively, these differences totaled over \$210k and \$39k. These dollars are depicted in gross numbers (adding both "under" and "over" discrepancies of the physical count compared to the perpetual inventory system) because we feel netting the discrepancies masks the underlying problem of inaccurate inventory tracking and reporting.

We recommend the Division redesign processes and procedures currently used to ensure inventory received from vendors is accurately entered into the Fleet Focus system and that all inventory used by mechanics is properly billed out and accounted for. Management should investigate and conclude whether the problems are in the receipt of inventory, usage of inventory, or whether inventory is being misappropriated. We further recommend, until the issue becomes more stable, that the Division conduct quarterly reviews to mitigate this area of risk.

### Department Response:

Our inventory tracking needs to accurately track the vast number of units passing through our system every year at a value of \$1.6M. Although we realize that we will not be able to attain perfection in inventory, there is room for improvement.

In 2009 the initial inventory difference (the sum of overages and underages) was \$210,000. Because of the large number, a reinventory was done at our Tahoe site since we have numerous sites with inventoried materials. Many of those were not counted at all in the original inventory. After the revised inventory the discrepancy was found to be approximately \$47K (\$33K in overages and \$14 in underages).

For context, 50% of the item discrepancy in this year's inventory is in bulk lubricants (ie oil). For cost effectiveness we buy lubricants in bulk by the barrel. Usage is estimated and billed out to the nearest quart. Our current meters measure to the quart, and because of age cannot be calibrated accurately. Although we are also investigating billings, a portion of the discrepancy is the inability to accurately measure and track usage of bulk materials. We are evaluating our ability and the cost to replace our current meters for bulk products to enhance accuracy.

Since August of this fiscal year we are performing monthly spot checks (approximately 30% of inventory) of a portion of the inventory to check for discrepancies. We have an Account Clerk double checking our data entry by comparing our mechanic's "part order tags" with the computer generated "work orders" for each service to locate discrepancies. Part order tags are now to be initialed by the individual doing data entry so that questions can be directed to the proper person. We are finding parts that sometimes are not billed or tracked correctly. We will continue this process until we feel that we have gotten as close as possible to an industry accepted value of discrepancies (5% of inventory).

The Department's responses to the recommendations identified in our review are described above. We did not audit the Department's responses and, accordingly, we express no opinion on them.

We appreciate the courtesy and cooperation of the Fleet Services Division staff and the Public Works Department throughout the course of this review.

Nicole C. Howard, CPA Internal Audit Manager

cc: Chuck Gordon, Fleet Manager, Public Works Department
Jim Geach, Assistant Fleet Superintendent, Public Works Department
Cynthia Taylor, Senior Administrative Services Officer, Public Works Department
Katherine Martinis, Auditor-Controller
Placer County Audit Committee