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Utilities Warehouse Inventory
Audit Report: 2021-A-0001
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Summary

What We Did

We conducted an inventory audit at the Martin County Utilities & Solid Waste Department (“Utilities” or “Department”) warehouse facility. The audit was performed to assess compliance with Section 218.33, Fla. Stat., which requires local governmental entities to establish and maintain a system of internal control designed to:

- a) Prevent and detect fraud, waste and abuse;
- b) Promote and encourage compliance with applicable laws, rules, contracts, grant agreements and best practices;
- c) Support economical and efficient operations;
- d) Ensure reliability of financial records and reports; and,
- e) Safeguard assets.

Additionally, our audit assessed the progress being made by Utilities in implementing the audit recommendations made by Moore Stephens Lovelace, P.A. (MSL) in its “Agreed-Upon Procedures – Utilities Warehouse” audit report, dated February 13, 2019.

What We Found

Utilities management should be recognized for implementing a number of recommendations made in MSL’s audit report. Corrective action includes, but is not limited to: (a) improving the warehouse facility; (b) increasing oversight of the warehouse contractor; and, (c) identifying and removing obsolete inventory. We categorized a number of additional recommendations as “pending implementation” as corrective action can be more fully evaluated after the inventory is restocked in the warehouse.

Although, Utilities has implemented a number of corrective actions, and its internal controls are generally operating as designed, opportunities exist to increase the efficiency, effectiveness and accountability of inventory at the warehouse facility.

Inventory Adjustments: Documentation supporting manual adjustments made in the inventory management system requires improvement.

Our evaluation included judgmentally selecting 24 parts from electronic source documents maintained by Utilities. Audit

procedures included matching the electronic records with physical records maintained by Utilities after performing its yearly count.

Our analysis identified eight end of fiscal year adjustments: five negative and three positive. However, only one part had an explanation in the comment section of the inventory management system, which stated "COUNT WAS OFF."

Moreover, there are two parts where our projected ending inventory quantity is less than what was reported to the Clerk's finance department. Based on our projection, ending inventory was **overstated by \$4,310.50**, roughly 10% of the sampled inventory value.

Quarterly Inventory Counts: Oversight and test counts should be performed quarterly for prominent use inventory.

Discrepancies should be documented and, if necessary, investigated.

After completing its fiscal year ending 2020 physical count, Utilities compared the results to electronic records maintained in the inventory management system. When a discrepancy is identified, an "adjusting" entry is made to reconcile the two counts. However, only one of the 10 parts identified in [Observation \(1\)](#) had an explanation for the adjustment. The comments section simply stated the "COUNT WAS OFF."

No matter how well procedures for recording purchases, work orders, and service orders are performed, several risk factors remain (*data entry, loss, theft, shrinkage, etc.*). To mitigate these risks, management should establish acceptable variances (tolerances) between the physical count and electronic inventory management system records. In situations where the variance exceeds management's tolerance, a root-cause analysis should be performed and documented.

Moreover, MSL's audit report made a similar recommendation that "oversight and test counts [should] be performed by Utilities Department personnel and/or the County's Internal Audit Department."

Inventory Management System Codes: Incorrect system codes were used when tracking inventory activity.

In 21 of 24 parts reviewed (87%) an incorrect system code was used for tracking inventory activity. Correctly tracking inventory activity reduces risk associated with stock outs, over purchasing and loss.

Incorrect system codes were identified when staff (a) issued stocked inventory to employees, and (b) when obsolete inventory was auctioned/disposed. This appears to be the result of MANCON (warehouse contractor) experiencing a number of staffing issues since contract award in April 2020. The inability to retain experienced warehouse staff resulted in inaccurate information being entered into the inventory management system.

Moreover, we understand that MANCON currently does not have two full time employees at the warehouse. This would appear to be in violation of the contract.

What We Recommend

We made eight recommendations that, if implemented, will strengthen the existing system of internal control by implementing test counts and, if necessary, conducting a root-cause analysis of variances exceeding tolerance levels established by management.

Martin County Clerk & Comptroller

The Florida Constitution established the clerk of the circuit court as the local constitutional officer who serves as the public trustee for the county. In addition to serving as the clerk to the courts, the clerk provides a county level system of checks and balances through services as the county comptroller, clerk to the board of county commissioners, guardian of public and official records, clerk to the value adjustment board and internal auditor of county funds.

Internal audit activity is established as a responsibility of the County Clerk & Comptroller by Florida Constitution Article VIII, §1, cl.(d) as the “ex officio clerk of the board of county commissioners, auditor, recorder and custodian of all county funds.” The internal audit activity is administered on the government operations of the County Clerk, and its functional divisions, and the Martin County Board of County Commissioners, and its functional divisions, as specified in the State Constitution, State Statutes and decisions and opinions of the State Judiciary.





Background

The Department was organized in conjunction with the purchase of Southern Gulf Utilities in 1981, which provided water to the Town of Sewall's Point by wholesale purchase of water from the City of Stuart. In 1984 the Utilities Department constructed its first water treatment facility (North System Treatment Plant). Subsequent milestones in the growth of the Department's utility system include the 1986 purchase of the Intercoastal Utilities water and wastewater system; the 1987 construction of the North County wastewater plant; the 1993 construction of the North System Reverse Osmosis Plant; the 1993 purchase of the Martin Downs Utility water and wastewater system; the 1994 construction of the Tropical Farms water and wastewater plant; and a major expansion of the Tropical Farms system which was completed in 2008.

The Department operates two business-type activities: The Utilities Department and the Solid Waste Department. The Martin County website provides the following distinction:

Martin County Utilities is a regional water and wastewater utility that provides service to unincorporated Martin County, the Town of Sewall's Point, and Ocean Breeze. Utilities also provides reuse (irrigation quality) water to local golf courses and residential subdivisions within the County. The Utilities currently treats on average 9 million gallons of water a day from 35 surficial and 4 floridan wells. The Martin County water system is interconnected between the Tropical Farms and North County water plants. Water treated at these plants is a combination of lime softening and reverse osmosis. The treatment process for both water, wastewater, and irrigation quality (reuse) water meets all of the requirements established by the federal, state, and local regulatory agencies.

Martin County Solid Waste provides safe and sanitary waste disposal for the residents of Martin County. It also provides efficient and cost-effective solid waste collection services to all residents and businesses of unincorporated county areas and recycling collection services to single and multi-family units countywide. Solid Waste assures compliance with local, state, and federal environmental regulations and helps divert hazardous waste from landfill disposal by educating residents and commercial entities on proper disposal and by providing opportunities for proper disposal of hazardous waste.

During fiscal year 2020, the Department engaged in some noteworthy capital asset, maintenance and construction projects, including:

- Tropical Farms Treatment Plant Wastewater Improvements
- Tropical Farms Treatment Plant Tertiary Filter Improvements
- Tropical Farms Water Plant Capacity Improvements
- North River Shores Vacuum Pump Building
- North River Shores Phase II Septic to Sewer
- North River Shores Gravity Sewer Pump Station
- Palm Lake Water Main Project
- Golden Gate Septic to Sewer
- Dixie Highway Corridor and Cove Road Force Mains

The Department's utility system service area encompasses a large portion of the unincorporated eastern section of the County where the majority of the population resides. The utility system service area essentially surrounds, and excludes, the City of Stuart, which is serviced by its own municipally-owned water and wastewater system. As of September 30, 2019, the Department had approximately 35,891 water and wastewater connections, providing service to an estimated population of 94,681 customers.

At the end of each fiscal year, Department staff conduct a physical count of all stocked parts at the warehouse. Afterward, the physical count is compared to electronic count records maintained in the inventory management system. If a discrepancy is identified, an "adjusting" entry is made to reconcile the two counts.

This process is typical in periodic inventory systems. Simply, inventory on hand is periodically determined by physically counting each stocked item at the end of a reporting period, *e.g. quarterly or annually*.

Review of Prior Audit Recommendations

MSL's "Agreed-Upon Procedures – Utilities Warehouse" audit report identified multiple areas for improvement and included a number of recommendations. Our audit included reviewing MSL's recommendations; obtaining responses from management describing its corrective action; and, where applicable, our evaluation of its implementation.



Warehouse Facility
1st Floor



Warehouse Facility
2nd Floor

Recommendation (1) – Condition of Inventory Storage Facility: County should evaluate warehouse facility needs and determine the best approach to ensuring warehouse inventory can be properly stored and managed.

Management Response/Corrective Action: *A second floor addition was added to the warehouse. The certificate of occupancy is expected to be issued by the end of March 2021. Warehouse employees attended training for the new inventory management system (IPS) and are in the process of entering parts into IPS.*

Internal Audit Comment: *Implemented.*

Recommendation (2) – Condition of Inventory Storage Facility: Inventory be stored on proper shelving and a location identification system be implemented so that inventory items can be easily located by anyone.

Management Response/Corrective Action: *Inventory is organized by classification. All inventory is labeled with the part name and inventory control number. Inventory is maintained in the inventory management system, which tracks the location of all parts. Specific parts can be looked up in the inventory management system, which will identify its location within the warehouse.*

Internal Audit Comment: *Pending Implementation. We can more fully evaluate if corrective action has been implemented once the warehouse facility is operational.*

Recommendation (3) – Annual Inventory Count: Oversight and test counts be performed by Utilities Department personnel and/or the County's Internal Audit Department.

Management Response/Corrective Action: *Inventory counts are being performed quarterly to correct any oversights or issues in advance of year-end inventory. All oversights are reviewed and corrective measures are implemented; however, quarterly counts were discontinued when construction began on the second-floor addition. Once the CO [certificate of occupancy] is received, and all of the parts are moved back into the warehouse, a complete count of all inventory will be performed.*

Internal Audit Comment: *Not Implemented. After further inquiry, management was unable to produce documentation supporting*

quarterly test counts for the period between issuance of the MSL audit report, February 13, 2019 and June 30, 2020.

Recommendation (4) - Warehouse Contractor Scope of Services—Purchasing: Work with the Warehouse Contractor to ensure that all Martin County Board of County Commissioners purchasing policies and procedures are being followed.

Management Response/Corrective Action: Purchasing policies are being followed... The Martin County Purchasing Manual has been provided to the warehouse contract employees.

Internal Audit Comment: Implemented. We did not uncover any circumstances of non-compliance with the Martin County Purchasing Manual.

Recommendation (5) - Warehouse Contractor Scope of Services—Purchasing: Warehouse Contractor better utilize inventory software to ensure the most efficient and effective utilization of inventory.

Management Response/Corrective Action: Warehouse contract employees attended training on the updated inventory management system. To assist in managing inventory, reorder level and maximum quantities are being entered into the inventory management system.

Internal Audit Comment: Pending Implementation. We can more fully evaluate if corrective action has been implemented once the warehouse facility is operational.

Recommendation (6) - Warehouse Contractor Scope of Services—Receiving: Evaluate any OSHA and Martin County Board of County Commissioners requirements related to the warehouse operations and request that the Warehouse Contractor follow applicable requirements and provide any necessary training to Warehouse Contractor personnel.

Management Response/Corrective Action: The Warehouse Contract employees have received training and are certified in forklift operation. The Warehouse Contract Employees are scheduled to take the Martin County Hazardous Communications, Ladder/Fall/Walking and Work Surfaces, Heat Stress, and Safe Lifting/Ergonomics training.

Internal Audit Comment: Implemented (on-going).

Recommendation (7) – Warehouse Contractor Scope of Services

—**Receiving:** Notify the Warehouse Contractor of concerns related to the accuracy of inventory maintained in the detail inventory records and, if necessary, provide the applicable training and supervision to ensure the accuracy of Utility Department inventory at a minimum at year-end.

***Management Response/Corrective Action:** Warehouse concerns have been discussed with MANCON [contractor]. Additionally, a Martin County employee is working full-time at the warehouse to ensure that all aspects of the contract are being followed.*

***Internal Audit Comment:** Implemented. Utilities has designated a full-time employee to be present at the warehouse to facilitate contract compliance.*

Recommendation (8) – Warehouse Stocked Inventory: Evaluate any OSHA and Martin County Board of County Commissioners requirements related to the Warehouse Stocked Inventory and request that the Warehouse Contractor follow applicable requirements and provide any necessary training to Warehouse Contractor personnel.

***Management Response/Corrective Action:** Warehouse Contract employees are counting all parts upon arrival to ensure that the amount ordered is actually what was delivered by the vendor. Only the actual amount counted is being entered into the inventory management system.*

To assist in managing inventory, reorder level and maximum quantities are being entered into the inventory management system.

***Internal Audit Comment:** Pending Implementation. We can more fully evaluate if corrective action has been implemented once the warehouse facility is operational.*

Recommendation (9a) – Warehouse Stocked Inventory: Work with the Warehouse Contractor to evaluate space needs for the long-term storage of inventory.

***Management Response/Corrective Action:** The construction of a large storage facility at the Martin Downs Plant site is going out to bid. Once construction is completed, equipment currently stored at the exterior warehouse space will be moved to the new storage facility,*

thereby creating more space for the warehouse to better organize inventory.

Recommendation (9b) – Warehouse Stocked Inventory: Until a long-term solution is found for additional space needs, the current space should be evaluated and reorganized to better identify and maintain current inventory.

Management Response/Corrective Action: *Prior to construction of the second-floor addition to the warehouse, old and obsolete parts were removed from inventory and either discarded or boxed for auction to create additional space. While under construction inventory is being maintained in Conex containers or the pole barn. Once the certificate of occupancy is issued the inventory will be reorganized and relabeled.*



Conex containers

Internal Audit Comment: *Pending Implementation. We can more fully evaluate if corrective action has been implemented once the warehouse facility is operational.*

Recommendation (10) – Inventory Distribution: Warehouse Contractor personnel and Utilities Department personnel coordinate documentation requirements and procedures related to inventory distribution.

Management Response/Corrective Action: *Included in MANCON's Standard Operating Procedures, section titled Process Overview. Additionally, Utilities is in the process of developing standard operating procedures for the warehouse.*

Internal Audit Comment: *Pending Implementation.*

Recommendation (11) – Other: Management should reiterate to the Warehouse Contractor that it is their responsibility to provide weekly transaction reporting, including appropriate backup documentation, in accordance with the Agreement (contract).

Management Response/Corrective Action: *Weekly transaction are not being generated until the updated information management system is fully functional.*

Internal Audit Comment: *Implemented. We reviewed a weekly transaction report for the period between August 3, 2020 and August*

7, 2020. Furthermore, we understand that weekly transaction reports are stored electronically on the "T: Drive" for management review.

Recommendation (12) – Warehouse Contractor Management

Oversight: Management should evaluate the amount of oversight by the Warehouse Contractor of its personnel and determine an appropriate level of oversight and expectations for the warehouse operations. Warehouse Contractor personnel indicated that there was minimal oversight of the Utilities Department Warehouse.

Management Response/Corrective Action: *Utilities has designated a full-time employee to be present at the warehouse to ensure contract compliance.*

Internal Audit Comment: *This recommendation appears to be directed at MANCON's oversight of its contract employees; not Utilities oversight of MANCON's contract employees.*

Recommendation (13) – Project Related Inventory:

Management should evaluate how project inventory is accounted for to ensure all project costs are properly accounted for and that there is a procedure in place to track, maintain, or obtain credit for any unused project inventory.

Management Response/Corrective Action: *Project inventory mostly pertains to Capital Improvement Projects (CIP) that are approved by the Martin County Board of County Commissioners. Project inventory is stored at the warehouse but is managed by the project manager for that specific project. It is not considered daily operations inventory. Any unused project inventory that may be used at a later date is received into the IPS system, labeled, then stored in the appropriate aisle based on its classification. Moreover, Utilities has been working with the Information Technology Department on how to best manage CIP inventory, primarily water meters, in the IPS system.*

Internal Audit Comment: *Pending Implementation.*

Recommendation (14) – Obsolete Inventory:

Warehouse Contractor personnel and Utilities Department personnel should perform an assessment for potential obsolete inventory and either: (1) dispose of any such inventory; or, (2) properly label the inventory for potential future use.

Management Response/Corrective Action: *Old and obsolete parts have been removed from inventory and either discarded or boxed for auction to create space as well as to keep only inventory needed in the warehouse. This is an ongoing process.*

Internal Audit Comment: *Implemented.*

Recommendation (15) – Obsolete Inventory: Obsolete Inventory should be properly removed from the Utilities Department inventory accounting system.

Management Response/Corrective Action: *Old and obsolete parts have been removed from inventory and boxed for auction to create space as well as to keep only inventory needed in the warehouse. All obsolete inventory has been adjusted properly in the IPS system.*

Internal Audit Comment: *Implemented.*

Recommendation (16) – Space Utilization: Underutilized exterior space: consider this underutilized storage space in the overall evaluation of inventory storage needs.

Management Response/Corrective Action: *The exterior warehouse space is currently stocked with grinder station wet wells, pumps, motors as well other large and/or heavy parts that need the forklift to maneuver them. The inventory stored inside the warehouse must remain there because the parts cannot be openly exposed to the outdoor elements and/or are small. The construction of a large storage facility at the Martin Downs Plant site is going to bid. Once the construction is completed, equipment currently stored at the exterior warehouse space will be moved to the new storage facility thus creating more space for the warehouse to better organize inventory.*

Internal Audit Comment: *Pending Implementation.*

Observations and Recommendations

Our evaluation of the existing system of internal control included judgmentally selecting 24 parts from electronic source documents maintained by Utilities. Audit procedures including matching the electronic records with physical count records maintained by Utilities.

Physical count records contain handwritten notes (numbers) by staff that support the quantity parts on the date the count was performed. The physical inventory count is performed throughout the month of September.

After determining the quantity and average cost of each stocked warehouse item, Utilities submits an “end of fiscal year inventory” report to the Clerk’s finance department. The finance department uses this document as its basis for adjusting inventory from its carrying value to its actual value.

Our audit included:

- a) Ensuring that, where applicable, adjustments were made when parts were issued between the date of the physical count and September 30, 2020; and,
- b) Comparing the “actual” ending inventory quantity identified by Utilities to the “projected” ending inventory calculated by internal audit.

“Projected” ending inventory was calculated by considering the following factors:

| | |
|-----|---|
| | Beginning Inventory (FY19 - Ending Inventory) |
| + | Receipt (Purchases) |
| = | Available Warehouse Inventory |
| - | Issued (Work Order or Service Order) |
| - | Transferred (Work Order or Service Order) |
| +/- | Adjustments |
| = | <u>Projected Ending Inventory</u> |

Utilities uses Infor Public Sector (IPS), an inventory management system, to continuously monitor stocked inventory balances.

Observation (1)

Inventory Adjustments: Documentation supporting manual adjustments made in the inventory management system requires improvement.

Internal Audit Review

At the end of the fiscal year, Utilities staff performs a comprehensive inventory count. During the month of September, staff counts and records the number of stocked parts in the warehouse.

When the physical count does not match electronic records, an “adjustment” is made in the inventory management system to reconcile the two counts. Adjustments can be positive or negative.

We noted that activity occurring between the date of the physical count and September 30, was considered prior to submitting the “end of fiscal year inventory” report to the Clerk’s finance department.

Our sample included end of year adjustments for 10 of the 24 parts reviewed. Although some of the differences between the quantities recorded in the inventory management system and the physical count could be a simple clerical error, we provide the following analysis for management’s consideration.

Seven parts are discussed in the “Negative Adjustments” section, while three parts are discussed in the “Positive Adjustments” section.

NEGATIVE ADJUSTMENTS

Using to our methodology (*above*), there are two parts where our projected inventory quantity was less than that reported to the Clerk’s finance department. Based on our projection, ending inventory was **overstated by \$4,310.50**; roughly 10% of the sampled inventory value.

The following parts had negative adjustments or required further discussion:

| Part Number | IPS Quantity | Physical Count | Negative Adjustment |
|-------------|--------------|----------------|---------------------|
| UT000950 | 42 | 23 | See below |
| UT000990 | 85 | 62 | (23) |
| UT001000 | 171 | 150 | (21) |
| UT001140 | 96 | 91 | (5) |
| UT001248 | 3 | 2 | (1) |
| UT507012 | 14 | 9 | See below |

| | | | |
|----------|----|----|-----|
| UT508115 | 43 | 36 | (7) |
|----------|----|----|-----|

Internal Audit analysis:

Part UT000950: 5/8" Neptune Meter with Electronic Read

- September 18: Inventory management system recorded 42 stocked meters.
- September 21: Physical count recorded 23 stocked meters.
- **No adjustment** was made to reconcile inventory management system records to the physical count.
- Four meters were issued between September 21 and September 30.
- Utilities reported 38 meters to the Clerk's finance department.

Internal Audit Analysis

To reconcile the electronic records (42) with the physical count (23), Utilities staff should have entered a **negative adjustment of 19 parts** into the inventory management system. However, because inventory was not adjusted the ending inventory was **overstated** by 19 parts, or **\$3,521.65¹**.

Part UT000990: 5/8" Badger Meter with Electronic Read

- September 18: Inventory management system recorded 85 parts.
- September 21: Physical count recorded 62 parts.
- 13 parts were issued between September 21 and September 30.

Internal Audit Analysis

To reconcile the electronic records (85) with the physical count (62), Utilities staff entered a **negative adjustment of 23 parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

Additionally, Utilities staff **correctly adjusted** for the number of issued parts between the time of physical count and the end of the

¹ At the end of fiscal year 2020, the average cost of a 5/8" Neptune meter with an electric read was \$185.35. Therefore, ending inventory was overstated by \$3,521.65 (19 x \$185.35).

fiscal year when it reported 49 stocked parts to the Clerk's finance department.

However, using our methodology, we project ending inventory should have been 43 meters. Based on our projection, ending inventory was **overstated** by six parts, or **\$758.52²**.

Part UT001000: 5/8" Neptune Meter

- August 5: Physical count resulted in a **negative adjustment of 15 parts** into the inventory management system.
- September 18: Inventory management system recorded 171 parts.
- September 21: Physical count recorded 150 parts.

Internal Audit Analysis

To reconcile the electronic record (171) with the physical count (150), Utilities staff entered a **negative adjustment of 21 parts** into the inventory management system.

Adjustment was made using the FYI (fiscal year inventory adjustment) code, with an explanation stating "count was off."

Management should note this negative adjustment occurred approximately 7 weeks after a physical count on August 5 when the electronic record was reduced by 15 parts.

Part UT001140: 5/8" Brass Dual Check

- April 30: A **negative adjustment of 98 parts** was entered into the inventory management system. Comment section notes an adjustment was required to correct inventory that "was receipted twice by mistake on April 7th, 2020."

A detailed transaction report obtained from the inventory management system identified two receipting transactions on April 7th:

Transaction #1262851: 48 parts

Transaction #1262863: 100 parts

- September 9: Inventory management system recorded 96 parts.

² At the end of fiscal year 2020, the average cost of a 5/8" **Badger** meter with an electric read was \$126.42. Therefore, ending inventory was overstated by \$758.52 (6 x \$126.42).

- September 10: Physical count recorded 91 parts.
Internal Audit Analysis
 To reconcile the electronic record (96) with the physical count (91), Utilities staff entered a **negative adjustment of 5 parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

Part UT001248: 2” Brass Curb Stop PVC Comp.

- September 15: Inventory management system recorded three stocked parts.
- September 17: Physical count recorded two stocked parts.

Internal Audit Analysis
 To reconcile the electronic record (3) with the physical count (2), Utilities staff entered a **negative adjustment of one part** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

We reviewed the detailed transaction report from the inventory management system, which listed the following fiscal year 2020 activity:

- Receipts (purchases): 0
- Issued: 1

Additionally, we reviewed documentation submitted to the Clerk’s finance department at the end of fiscal year 2019. This report identified four stocked parts. Using this data, in conjunction with our methodology, we calculated the projected ending inventory as:

| | |
|---|-----|
| Beginning Inventory (FY19 – Ending Inventory) | 4 |
| + Receipt (Purchases) | 0 |
| = Available Warehouse Inventory | 4 |
| - Issued (Work Order or Service Order) | - |
| - Transferred (Work Order or Service Order) | (1) |
| +/- Adjustments | - |
| = Projected Ending Inventory | 3 |

However, the physical count performed by Utilities recorded only two parts. We list three possible reasons for this discrepancy:

1. Fiscal year ending 2019 inventory was not recorded properly;
2. A transaction (*issued/transferred*) was not recorded in the inventory management system; or,
3. Fiscal year ending 2020 inventory was not recorded properly.

Part UT507012: Diversified SLA-230-ASA Phase Monitor

- September 21: Inventory management system recorded 14 stocked parts.
- September 22: Physical count recorded 9 stocked parts.

Internal Audit Analysis

To reconcile the electronic record (14) with the physical count (9), Utilities staff entered a **negative adjustment of five parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

We reviewed the detailed transaction report from the inventory management system, which listed the following fiscal year 2020 activity:

- Receipts (purchases): 24
- Issued: 23
- Transferred: 31

Additionally, we reviewed documentation submitted to the Clerk's finance department at the end of fiscal year 2019. This report identified 11 stocked parts. Using this data, in conjunction with our methodology, we calculated the projected ending inventory as:

| | |
|---|------|
| Beginning Inventory (FY19 - Ending Inventory) | 11 |
| + Receipt (Purchases) | 24 |
| = Available Warehouse Inventory | 35 |
| - Issued (Work Order or Service Order) | (23) |

| | | |
|-----|---|-------------|
| - | Transferred (Work Order or Service Order) | (31) |
| +/- | Adjustments | (5) |
| = | <u>Projected Ending Inventory</u> | <u>(24)</u> |

Clearly, you cannot have negative inventory. Our projected inventory is in stark contrast to the physical count conducted by Utilities, which recorded nine meters. We list five possible reasons for this discrepancy:

1. Fiscal year ending 2019 inventory was not recorded properly;
2. A purchase(s) in fiscal year 2020 was not recorded;
3. Duplicative transactions (*issued/transferred*);
4. A transaction (*issued/transferred*) was mistakenly attributed to this part; and/or,
5. Fiscal year ending 2020 inventory was not recorded properly.

Part UT508115: 3/4" Straight Liquidtight Connector

- September 8: Inventory management system recorded 43 parts.
- September 21: Physical count recorded 36 parts.

Internal Audit Analysis

To reconcile the electronic record (43) with the physical count (36), Utilities staff entered a **negative adjustment of seven parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

POSITIVE ADJUSTMENTS

Using to our methodology, the ending inventory value for part #UT447574, as reported to the Clerk's finance department, was **overstated by \$30.33**.

The following parts had positive adjustments:

| Part Number | IPS Quantity | Physical Count | Positive Adjustment |
|-------------|--------------|----------------|---------------------|
| UT001345 | 27 | 28 | +1 |
| UT302620 | 26 | 28 | +2 |
| UT347574 | 4 | 10 | +6 |

Internal Audit analysis:

Part UT001345: 1" Brass U Branch In-Line CTS

- September 9: Inventory management system recorded 27 stocked parts.
- September 9: Physical count recorded 28 stocked parts.

Internal Audit Analysis

To reconcile the electronic record (27) with the physical count (28), Utilities staff entered a **positive adjustment of one part** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

We reviewed the detailed transaction report from the inventory management system, which listed the following fiscal year 2020 activity:

- Receipts (purchases): 0
- Issued: 0
- Transferred: 14

Additionally, we reviewed documentation submitted to the Clerk's finance department at the end of fiscal year 2019. This report identified 40 stocked parts. Using this data, in conjunction with our methodology, we calculated the projected ending inventory as:

| | |
|---|------|
| Beginning Inventory (FY19 - Ending Inventory) | 40 |
| + Receipt (Purchases) | 0 |
| = Available Warehouse Inventory | 40 |
| - Issued (Work Order or Service Order) | - |
| - Transferred (Work Order or Service Order) | (14) |
| +/- Adjustments | 1 |
| = Projected Ending Inventory | 27 |

Utilities staff **correctly accounted** for the number of issued parts between the time of physical count and the end of the fiscal year when it reported 27 stocked parts to the Clerk's finance department.

Part UT302620: 4" x 1 ¼" IPS Tap Tee

- September 8: Inventory management system recorded 26 stocked parts.

- September 8: Physical count recorded 28 stocked parts.

Internal Audit Analysis

To reconcile the electronic record (26) with the physical count (28), Utilities staff entered a **positive adjustment of two parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

We reviewed the detailed transaction report from the inventory management system, which listed the following fiscal year 2020 activity:

- Receipts (purchases): 20
- Issued: 0
- Transferred: 7

Additionally, we reviewed documentation submitted to the Clerk's finance department at the end of fiscal year 2019. This report identified 12 stocked parts. Using this data, in conjunction with our methodology, we calculate the projected ending inventory as:

| | |
|---|-----|
| Beginning Inventory (FY19 - Ending Inventory) | 12 |
| + Receipt (Purchases) | 20 |
| = Available Warehouse Inventory | 32 |
| - Issued (Work Order or Service Order) | - |
| - Transferred (Work Order or Service Order) | (7) |
| +/- Adjustments | 2 |
| = Projected Ending Inventory | 27 |

Utilities staff **correctly accounted** for the number of issued parts between the time of physical count and the end of the fiscal year when it reported 27 stocked parts to the Clerk's finance department.

Part UT347574: MK73/B84B Weather Shield

- September 10: Inventory management system recorded four stocked parts.
- September 16: Physical count recorded 10 stocked parts.

Internal Audit Analysis

To reconcile the electronic record (4) with the physical count (10), Utilities staff entered a **positive adjustment of 6 parts** into the inventory management system.

Other than using the code FYI (fiscal year inventory adjustment) there is no further explanation for the adjustment.

We reviewed the detailed transaction report from the inventory management system, which listed the following fiscal year 2020 activity:

- Receipts (purchases): 0
- Issued: 28

Additionally, we reviewed documentation submitted to the Clerk's finance department at the end of fiscal year 2019. This report identified 29 stocked parts. Using this data, in conjunction with our methodology, we calculated the projected ending inventory as:

| | |
|---|------|
| Beginning Inventory (FY19 - Ending Inventory) | 29 |
| + Receipt (Purchases) | 0 |
| = Available Warehouse Inventory | 29 |
| - Issued (Work Order or Service Order) | (28) |
| - Transferred (Work Order or Service Order) | - |
| +/- Adjustments | 6 |
| = Projected Ending Inventory | 7 |

Using to our methodology, we project ending inventory should have been seven parts; however, Utilities reported 10 stocked parts to the Clerk's finance department.

Based on our projection, ending inventory would have been **overstated by \$30.33³**.

Recommendations

1. When end of fiscal year adjustments exceed established tolerances, management should fully document the reason for change in the inventory management system.

Additional guidance is provided in Observation (2).

³ At the end of fiscal year 2020, the average cost of Weather Shield was \$10.11. Therefore, ending inventory was overstated by \$30.33 (3 x \$10.11).

Response

Martin County agrees with our recommendations.

The Utilities Department has implemented procedures regarding all adjustments made in the IPS Asset/Inventory Management system. If an adjustment is made, for any reason, the proper adjustment code shall be used and a comment stating the reason for the adjustment must be documented in the IPS Asset/Inventory Management system. Warehouse vendor will generate a weekly transaction report to be reviewed by County staff.

Observation (2)

Quarterly Inventory Counts: Oversight and test counts should be performed quarterly for frequently used inventory.

Discrepancies should be documented and, if necessary, investigated.

Internal Audit Review

As more fully explained in [Observation \(1\)](#), at the end of each fiscal year, Utilities staff conducts a physical count of all stocked parts. The physical count is compared to electronic records maintained in the inventory management system. If a discrepancy is identified, an “adjusting” entry is made to reconcile the two counts.

No matter how well procedures for recording purchases, work orders, and service orders are performed, several risk factors remain (*data entry, loss, theft, shrinkage, etc.*). One method to mitigate these risks is for management to establish acceptable variances (tolerances) when there is a difference between the physical count and inventory management system records. In situations where the variance exceeds management’s risk tolerance, a root-cause analysis should be performed.

One way to classify parts is by assessing their relative importance in maintaining the water/wastewater/sewer infrastructure and assigning them a code. For example, inventory “ABC” codes are a common way to classify parts, where:

“A” – high value or critical item;

“B” – intermediate cost and critical item, and

“C” – low cost item that could be critical if you don’t have it.

For each “ABC” code management establishes an allowed range of variation. An “A” item should have a lower range of variability than a “C” item.

Although there are a number of situations that would cause the electronic records to differ from the physical count (*improper recording, failure to record a work/service order, breakage, or theft*), in most cases, it does not appear Utilities initiated a root-cause analysis.

In fact, only one of the 10 parts identified in **Observation (1)** had an explanation for the end of year adjustment—5/8” Neptune Meter—where the comment section stated the “COUNT WAS OFF.” It’s important to note that less than 60 days prior to the end of year adjustment of -21 parts, Utilities conducted a physical count. That count resulted in an adjustment of -15 parts. The comment section explained it was an “INVENTORY ADJUSTMENT.”

Because the adjustments occurred less than 60-days apart, in our opinion, it should have been more fully reviewed. These two adjustments reduced inventory valuation by \$2,200.00.

Finally, MSL in its previously issued audit report made a similar recommendation when it offered that “oversight and test counts be performed by Utilities Department personnel and/or the County’s Internal Audit Department.”

Recommendations

2. The Utilities department should perform quarterly oversight and test counts of frequently used, critical, inventory.
3. Management should establish acceptable tolerances between inventory management system records and physical counts.
4. When the variance between the inventory system records and the physical count exceeds management’s tolerance, an independent verification count should be performed. The verification count should be performed by a staff member who did not participate in the original count.

5. After **verification**, a documented root cause analysis should be performed and appropriate solutions implemented.

Response

Martin County agrees with our recommendations.

Quarterly test counts will be performed every January, April, and July on all brass, stainless steel, and fusion parts, which are the most issued parts. Furthermore, due to the frequent use of supplies, all supplies (consumables i.e. gloves, safety glasses, disinfectant soap, etc.) will be counted quarterly as well. A complete inventory count is completed every September. Any oversights or errors will be addressed to the warehouse staff. Corrective procedures will be drafted and implemented as necessary.

The Utilities Department has established that the acceptable tolerance rate or goal be less than 3%. Any variance over 5% is unacceptable. The warehouse has recently completed the addition of a second floor to provide more space and improved organization of the inventory. This addition along with the new IPS Asset/Inventory Management system will provide the necessary tools to achieve our acceptable tolerance level goal.

If the inventory records exceed the acceptable tolerance, two Utilities staff members that are familiar with the warehouse procedures and the IPS Asset/Inventory Management system will perform a verification count.

The findings of the verification count will be documented in a detailed report along with all solutions to correct the issues. Training will be provided to prevent a recurrence of errors.

Observation (3)

Inventory Management System Codes: Incorrect system codes were used when tracking inventory activity.

Internal Audit Review

In 21 of 24 parts reviewed (87%) an incorrect system code was used when tracking inventory activity. Correctly tracking inventory

activity reduces risk associated with stock outs, over-purchasing and loss.

Incorrect system codes were identified when staff (a) issued stocked inventory to employees, and (b) when obsolete inventory was auctioned/disposed.

We understand the County entered into a service contact with MANCON, LLC, dated April 7, 2020, for the “day to day operations” of the warehouse, including “ordering, receiving, storing and issuing equipment, parts, tool and supplies through a computerized warehouse inventory/work order asset system... warehouse inventory is maintained in IPS (Infor Public Sector – Hansen) software... instructions and training will be provided by MCU [Martin County Utilities].”

As described in the “inventory distribution” section of the scope of services, MANCON is responsible for (a) providing accurate data entry of all materials that are issued from the warehouse and (b) providing accurate data entry of all material that is returned by employees and/or contractors. Moreover, in the “minimum staffing requirements” section, MANCON “must provide a minimum of two full time employees... to carry out all contract requirements.”

We understand that MANCON has experienced a number of staffing issues since the contract was awarded. The inability of MANCON to retain experienced warehouse staff has resulted in inaccurate information being entered into the inventory management system.

Finally, we understand that MANCON does not currently have two full time employees at the warehouse. This would appear to be in violation of the contract.

Recommendations

6. Management should insure MANCON complies with the contract provision requiring it to “provide a minimum of 2 full time employees” at the warehouse.
7. The “Inventory Procedures” document should be updated to reflect current Utilities department operations. This document should reflect any new processes that have been experienced as a result of the new inventory management system environment.

Management is reminded that **procedures** should:

- Be communicated to all officials and appropriate employees.
- Be designed to promote the conduct of authorized activities in an effective, efficient and economical manner.
- To reduce the possibility of fraud and error, procedures should be coordinated so that one employee's work is checked by another who is independently performing separate duties.
- For non-mechanical operations, procedures should not be so detailed as to stifle the use of judgment.
- Procedures should not be overlapping, conflicting or duplicative.
- Procedures should be periodically reviewed and improved as necessary.

8. Management should provide ongoing inventory management system software training to MANCON staff and reinforce the importance of using correct inventory codes.

Response

Martin County agrees with our recommendations.

Utilities staff discussed the staffing contract provision with MANCON at a meeting that took place on June 14, 2021. MANCON agreed to this provision and two (2) fulltime employees have been present at the warehouse.

The "Inventory Procedures" document is in the process of being updated to reflect the changes to the standard operating procedures that have been made due to the new IPS Asset/Inventory Management system.

The importance of using the correct inventory codes has been stressed to the MANCON staff as well as providing detailed comments when adjustments to stock quantities are made. The ITS department has created a detailed user guide for all components of the IPS Asset/Inventory Management system. Members of the Utilities' staff have been trained in the IPS

Asset/Inventory Management system and are available to assist the MANCON employees.

Audit Objectives

The Martin County Commission (“County”) is responsible for establishing and implementing a system of internal control designed to provide a reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance.

The audit was initiated to address the following **objectives**:

- Provide a reasonable assurance of fiscal year ending 2020 warehouse inventory valuations;
- Assess implementation of any corrective action initiated as a result of the MSL audit; and,
- Assess the internal control environment for stocked warehouse inventory.

Internal Auditing is an “independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”⁴

Audit Scope

The **scope** of this audit is to review inventory activity during the period between October 1, 2019 through September 30, 2020, the County’s fiscal year.

Audit Methodology

Audit **procedures** included, but were not limited to:

- Reviewing information maintained in Utilities’ customer information system (Banner CIS).
- Reviewing source documents maintained in the County’s financial system (Banner).
- Physical examination of the warehouse facility.
- Reviewing inventory tabulation sheets.
- Reviewing system generated inventory management reports.
- Reconciling a sample of warehouse inventory parts.
- Inspection of records and documents.

⁴ International Professional Practices Framework, definition of Internal Auditing.

- Interviewing County staff.

The audit was planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for our comments and conclusion based upon the audit objectives. This audit report is intended to provide management, and those charged with governance and oversight, with information to improve program performance and operations, reduce cost, facilitate decision making by parties with responsibility to oversee or initiate corrective action and contribute to public accountability. We believe that the evidence obtained provides a reasonable basis for our comments and conclusions based upon our stated objectives.

Acknowledgement

Internal Audit staff would like to extend our appreciation to Utilities & Solid Waste department staff for the cooperation and courtesies extended to us in the completion of this report.

**MARTIN COUNTY, FLORIDA
INTER-OFFICE MEMORANDUM**

www.martin.fl.us

2401 SE Monterey Road, Stuart, Florida 34996

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TO: Hank K. Nagel, Internal Auditor

DATE: 07/23/2021

VIA: Taryn Kryzda, County Administrator

FROM: Don G. Donaldson, Deputy County
Administrator

SUBJECT: Utilities Warehouse Inventory – Draft Audit Report 2021-A-0001

This memorandum has been prepared as requested and in response to the above-mentioned draft audit report of the inventory at the Martin County Utilities & Solid Waste Department (Utilities Department) warehouse facility, as conducted by the Clerk of the Circuit Court and Comptroller (Clerk).

Thank you for the comprehensive assessment of the inventory at the warehouse facility in Utilities. We appreciate the thoughtful observations and consequent recommendations designed to assist the Utilities Department improve the related policy and efficiency of the program.

You will find agreement with essentially all of the recommendations made and a plan for suggested improvements.

The following are the County Administrator's responses to each of the specific recommendations contained in the draft inventory audit report (2021-A-0001).

OBSERVATION 1

***Inventory Adjustments:** Documentation supporting manual adjustments made in the inventory management system requires improvement.*

- 1. When end of fiscal year adjustments exceeds established tolerances, management should fully document the reason for the change in the inventory management system.*

RESPONSE 1:

Agreed. The Utilities Department has implemented procedures regarding all adjustments made in the IPS Asset/Inventory Management system. If an adjustment is made, for any reason, the proper adjustment code shall be used and a comment stating the reason for the adjustment must be documented in the IPS Asset/Inventory Management system. Warehouse vendor will generate a weekly transaction report to be reviewed by County staff.

OBSERVATION 2

Quarterly Inventory Counts: Oversight and test counts should be performed quarterly for prominent use inventory. Discrepancies should be documented and, if necessary, investigated.

2. *The Utilities Department should perform quarterly oversight and test counts of frequently used, critical inventory.*
3. *Management should establish acceptable tolerances between inventory management system records and physical counts.*
4. *When the variance between the inventory system records and the physical count exceeds management's tolerance, an independent verification count should be performed. The verification should be performed by a staff member who did not participate in the original count.*
5. *After verification, a documented root cause analysis should be performed, and appropriated solution implemented.*

RESPONSE 2:

Agreed. Quarterly test counts will be performed every January, April, and July on all brass, stainless steel, and fusion parts, which are the most issued parts. Furthermore, due to the frequent use of supplies, all supplies (consumables i.e. gloves, safety glasses, disinfectant soap, etc.) will be counted quarterly as well. A complete inventory count is completed every September. Any oversights or errors will be addressed to the warehouse staff. Corrective procedures will be drafted and implemented as necessary.

RESPONSE 3:

Agreed. The Utilities Department has established that the acceptable tolerance rate or goal be less than 3%. Any variance over 5% is unacceptable. The warehouse has recently completed the addition of a second floor to provide more space and improved organization of the inventory. This addition along with the new IPS Asset/Inventory Management system will provide the necessary tools to achieve our acceptable tolerance level goal.

RESPONSE 4:

Agreed. If the inventory records exceed the acceptable tolerance, two Utilities staff members that are familiar with the warehouse procedures and the IPS Asset/Inventory Management system will perform a verification count.

RESPONSE 5:

Agreed. The findings of the verification count will be documented in a detailed report along with all solutions to correct the issues. Training will be provided to prevent a recurrence of errors.

OBSERVATION 3

Inventory Management System Codes: Incorrect system codes were used when tracking inventory activity.

6. *Management should ensure MANCON complies with the contract provision requiring it to "provide a minimum of 2 full time employees" at the warehouse.*
7. *The "Inventory Procedures" document should be updated to reflect current Utilities department operations. This document should reflect any new processes that have been experienced as a result of the new inventory management system environment.*
8. *Management should provide ongoing inventory management system software training to MANCON staff and reinforce the importance of using correct inventory codes.*

RESPONSE 6:

Agreed. Utilities staff discussed the staffing contract provision with MANCON at a meeting that took place on June 14, 2021. MANCON agreed to this provision and two (2) fulltime employees have been present at the warehouse.

RESPONSE 7:

Agreed. The "Inventory Procedures" document is in the process of being updated to reflect the changes to the standard operating procedures that have been made due to the new IPS Asset/Inventory Management system.

RESPONSE 8:

Agreed. The importance of using the correct inventory codes has been stressed to the MANCON staff as well as providing detailed comments when adjustments to stock quantities are made. The ITS department has created a detailed user guide for all components of the IPS Asset/Inventory Management system. Members of the Utilities' staff have been trained in the IPS Asset/Inventory Management system and are available to assist the MANCON employees.