# Internal Audit Department

# Audit Report 2017-4

## Fleet Management Division:

## 2016 Fiscal Year-End Inventory Observation

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# TABLE OF CONTENTS

Internal Audit provided a draft of this report to the Administrative Services Department Head and the Fleet Management Division Director for management response on January 25, 2017. County management provided that response on March 9, 2017.

# Summary

This review generated the following observations regarding the Fleet Management Division's 2016 fiscal year-end inventory:

- Parts classified as "no charge" are not consistently included in inventory.
- Inventory is not properly safeguarded.
- Inventory counts were not all neutral.
- Exceptions were noted when following-up on items not found during physical counts.
- Exceptions were noted when following-up on items found, but not counted during physical counts.
- Count adjustments exceeded expectations for a perpetual inventory system.

The review also generated the following other observations:

- There are inconsistencies in the application of Fleet Management Division's Career and Pay Incentive Policy that require clarification or revision. Specific areas of concern are:
  - Tool allowance for automotive technicians; and
  - Career development testing reimbursement.

Per an email from Len Golden Price, Administrative Services Department Head, dated October 24, 2016, Fleet Management staff was directed not to respond to any additional inquiries or observation follow-up from Internal Audit until an official audit engagement letter had been received. Any limitation of access to public records impairs the ability of Internal Audit to complete a thorough review and escalates the risk that fraud, waste, misuse, abuse or loss will go undetected and uncorrected.

# Objectives

The objective of the review was to validate the physical count and to confirm the respective costs of consumable supplies inventory reported by the Fleet Management Division.

# Scope

The review engagement consisted of, but was not limited to, the following tasks:

- Reviewing CMA 5809, Managing Personal Property and Consumable Supplies;
- Reviewing the Division's Inventory and Costing Process Narrative for the 2016 fiscal year-end;
- Inquiring of Fleet Management staff and management as to inventory processes;
- Observing Fleet Management's physical inventories of consumable supplies at each of their four storage locations;
- Haphazardly re-counting a sample of inventory items during the physical inventories and comparing re-counts to quantities reported by Fleet Management;
- Reviewing the detail and summary records generated by the Division from those physical inventories, including copies of actual inventory count sheets; and
- Reviewing invoices for a sample of parts for cost validation purposes.

As part of the review engagement, Internal Audit originally intended to review the perpetual inventory system by analyzing purchase invoices and work order charge outs for a sample of items. Without the full cooperation of Fleet Management, Internal Audit was unable to satisfactorily complete this element of the review.

# Background

Internal Audit issued Audit Report 2015-5 regarding the Fleet Management Division (Fleet) on July 1, 2015. The audit included a review of Fleet's inventory with inventory counts being observed in September 2013 and September 2014. The audit included several recommendations for improvements to Fleet's inventory policies, procedures and controls.

Fleet maintains eight inventory storerooms at four physical locations:

County Barn Road (Parts Room and Service Truck);
Immokalee (Parts Room and Service Truck);
Davis Boulevard (Parts Room and Trailer); and
Radio Road (Parts Room and Service Truck.)

Fleet uses the FASTER system to record inventory transactions and track inventory quantities and values.

Fleet reports their inventory to the Clerk's Finance Department for inclusion in Collier County's comprehensive annual financial reports.

On September 19, 2016, a Senior Operations Analyst for Fleet provided a schedule of physical inventory counts to the Clerk's Finance Department. The schedule was revised on September 20, 2016. The Chief Deputy Clerk dispatched Internal Audit to observe those inventory counts, and to analyze the resulting reported amounts.

# Observations

## 1) Parts classified as "no charge" are not consistently included in inventory.

"No charge" parts are acquired by Fleet at no discernable or new cost. Examples of "no charge" parts include:

- Parts salvaged from wrecked vehicles;
- Parts remaining from a kit, where only a specific part of the kit was needed to complete a repair;
- Warranty replacements, where the related warranty repair was completed using a stock part; and
- Parts and samples received from vendors at no charge.

Fleet Management does not currently have a policy in place to include "no charge" parts in inventory or otherwise track the existence of the items because there is no actual cost associated with the items.

Internal Audit observed "no charge" parts that existed, but were not recorded at all four of Fleet's inventory storage locations. Fleet has recorded a portion of their "no charge" inventory (primarily at the County Barn location), but as there is no policy in place to record the parts, a significant number of exceptions still exist.

Not recording "no charge" parts in inventory may result in overstocking, thus increasing carrying costs and obsolete inventory. By not actively tracking "no charge" parts that are new or used, but in good condition, Fleet is unnecessarily increasing their exposure to theft and fraud.

### Recommendations:

- Fleet Management should develop policies and procedures to include "no charge" parts in inventory.
- A mechanism should be implemented to actively track and monitor "no charge" parts.

### County Management Response:

*"Fleet Management has policies and procedures for inventory that include no charge parts. Fleet Management has been conducting continuous monitoring and assessment of no charge parts to determine the cost benefit of recording*

*these items and the carrying costs for the no charge parts. For each no charge part recorded there is a cost for storage space and maintenance of the items in the system, which can be very cost prohibitive for County staff. For each no charge part potential addition, Fleet Management conducts a review of the unique situation and determines whether the cost of adding the no charge part exceeds the benefit, then makes a decision accordingly.*

*Based on the assessment some no charge parts are not recorded because the cost outweighs the benefit. Part of County Management's responsibility is to evaluate risk. As part of this assessment, County Management has decided to accept this minimal risk because the cost to resolve outweighs the benefit. An example might be a repair kit that comes with several gaskets for different types of motors. The gaskets for the repair requirement are used but the others are remaining in the kit. We may be able to trim those gaskets to make them work somewhere else and maybe not, however we keep them around just in case. Keeping an inventory of these gaskets is not practical because those gaskets are not something we would ever order.*

*Since assuming the risk is a deviation from the current policy and procedure, the policy and procedures will be updated to reflect this practice and assumption of risk."*

Internal Audit Response: No charge parts as described have a cost that is combined in a larger order.

## 2) Inventory is not properly safeguarded.

Internal Audit observed parts rooms that were unsecured during business hours at three of the four Fleet inventory storage locations: Davis Boulevard, Radio Road and Immokalee.

Davis Boulevard:
Parts are stored in multiple open areas within the facility. The majority of parts are stored in an unsecured second level loft. The facilities are shared with another department who also uses the storage space on the second level. In order to access their storage, employees from the other department walk directly past Fleet's storage loft. In addition, several parts are stored outside, behind the facility, due to the size and weight of the parts. The entrance to the facility is gated, but there are no security cameras inside the storage areas.

Radio Road:
The parts room has two rolling doors, one leading to the main floor and the other outside. Both rolling doors are left open during business hours. The entrance to the facility is gated, but there are no security cameras inside the storage area.

Immokalee:
The door to the parts room is left unlocked or open. To enter the main office, customers have to walk through the parts room.

### Recommendations:

- Fleet Management should properly safeguard all inventories.
- Fleet Management should consider implementing a written policy that parts rooms be secured when personnel responsible for the inventory is not physically present.

### County Management Response:

*"Fleet Management strives to properly safeguard all inventories. In some instances, as noted, the options are not feasible and the costs are too high to implement the utmost solutions. In order to resolve the audit finding, Fleet Management would require three additional full-time employees to have one employee at each location at all times. In addition, major construction would be needed at two of the Fleet Management facilities. All reasonable and prudent actions have been taken to minimize risk and protect County property. Although it has been a common practice to secure Fleet facilities when Fleet personnel are not present, a written rule has be established as recommended."*

Internal Audit Response: The solution does not require the addition of employees but inventory control dictates that inventory be secured at all times. This may require the area to be locked with only access by designated personnel.

## 3) Inventory counts were not all neutral.

Blind counts involve a hands-on tabulation of inventory without access to quantities shown in the inventory system. Blind counts enhance the integrity of the process by reducing the incentive, consciously or subconsciously, to avoid conflict and discrepancy investigation by matching to system totals.

Initial counts for six of Fleet's eight storerooms were blind. The initial counts for two of the storerooms, service trucks maintained at County Barn Road and Radio Road, were not blind. The counter worked directly off a list that included all system inventory totals for the storeroom.

Follow-up counts, re-counts performed when the initial count did not agree to system quantities, were not blind. The counters worked directly off lists that showed system totals and the original count totals.

Counts performed for items included in system totals, but not counted or found in the initial count were not blind. The counters worked directly off lists that showed system totals.

**Recommendations:**

- Fleet Management should use blind counts throughout the physical inventory process to enhance the integrity of the process.

**County Management Response**:

*"Fleet Management uses two counters rather than blind counts for the service trucks based on the nature of the items and storage locations within the trucks to facilitate accuracy of the inventory count. Rather than using the blind count method, Fleet Management mitigates the risk of providing the count totals through having a second person for all counts.*

*For the review of discrepancies, count totals are provided for the system number and the actual count number so that employees know the general range for the independent count. The mitigating control is that a second team is comprised of different employees to ensure an impartial second count."*

Internal Audit Response: The use of two counters does not enhance the accuracy if both are provided the expected results, and in fact, indicates a duplication of flawed inventory counts. A count should be blind and discrepancies verified by a third party or supervisor.

## 4) Exceptions were noted when following-up on items not found during physical inventory counts.

Internal Audit observed the physical inventory counts for Davis Boulevard on September 28, 2016. During the count for the parts room, Fleet staff was unable to locate two guards (part #8097015) valued at a total of $1,632.88. As a result of the physical count, the inventory system was updated to report a quantity of zero for the item.

Upon further review by Fleet staff, it was determined that the guards had been installed on County equipment during a third-party repair in May of 2016. Fleet elected to add the two guards back into inventory in order to charge the parts out through the proper channels. On September 29, 2016, Fleet inadvertently added 20 guards back into the inventory system before charging out two. This input error left 18 guards in inventory with a total value of $14,695.92. The remaining 18 guards were adjusted off on October 2, 2016.

The 2016 fiscal year-end inventory totals provided by Fleet to the Clerk's Finance Department included the 18 guards. As a result, inventory reported by Fleet was overstated by $14,695.92.

In addition, Fleet staff was unable to locate several "U" fittings valued at $1,596.36 during the inventory count for the trailer stationed at Davis Boulevard. Per Fleet staff, the fittings were no longer compatible with any of Fleet's equipment. The same quantities and values had been reported for the "U" fittings by Fleet for the 2015 fiscal year-end inventory, indicating there had been no activity for the parts over the course of the fiscal year. As a result of the physical count, the inventory system was updated to reflect a quantity of zero for all of the "U" fittings.

Per Fleet staff, the fittings had been returned, but no credit had ever been received from the vendor. The related credit memo was not received by the Clerk's Finance Department until December 19, 2016, past year end.

A perpetual inventory system is highly dependent on the timeliness and reliability of the information being submitted. Returns and purchases should not be reconciled through the physical count process. Instead physical counts should be a verification that the system in place is functioning as designed. The integrity and value of the system requires the active and accurate tracking of inventory. Fleet staff should be consistently pursuing any lagging invoices or credits to prevent any delays in reporting and to ensure the timely collection of any credit due to the County.

**Recommendations:**

- Fleet Management should ensure that all inventory corrections and adjustments are made before submitting totals to the Clerk's Finance Department for inclusion in the County's comprehensive annual financial reports.
- Fleet should utilize a spreadsheet or similar mechanism to track any inventory removed from its reported location and not immediately charged out to a repair work order to avoid unnecessary count adjustments, delays and errors.
- Fleet should utilize a spreadsheet or similar mechanism to track inventory returned with credits pending. This would allow for a better accounting of inventory and aid in physical counts.

**County Management Response**:

*"Fleet Management agrees that information should be accurate and strives to provide accurate information. When errors are detected, Fleet Management promptly reports these errors and resolves them immediately. Procedures for issuing parts to vendors and monitoring pending credits will be reviewed and updated as needed."*

## 5) Exceptions were noted when following-up on items found, but not counted during physical inventory counts.

Internal Audit observed the physical inventory counts for Radio Road on September 27, 2016. During the count for the parts room, Fleet staff identified a number of tires (six of part #12R225 and four of part #22575R16FIR) that were not included in the count because the invoice for the tires had not been received. Fleet policy is to record inventory into the FASTER system directly off invoices.

Internal Audit obtained a copy of the related invoice. The invoice revealed that six of one other tire (part #27570R225FIR) had been included in the purchase. Fleet inadvertently made a count adjustment for these six tires, which goes against their policy of recording purchases directly off invoices.

Accrual accounting requires that any inventory received prior to fiscal year-end be included in inventory. Fleet reported the inventory related to the tire purchase at $1,907.98, as a result of the count adjustment for part #22570R225FIR. Based on the invoice, the inventory should have been reported at $4,617.08. As a result, fiscal year-end inventory was understated by $2,709.10.

**Recommendations:**

- Fleet should utilize a spreadsheet or similar mechanism to track inventory received with invoices pending. This would allow for a better accounting of inventory and aid in physical counts. Alternatively, Fleet could record inventory directly off the receiving documents instead of waiting for the related invoice.

**County Management Response**:

*"Fleet Management agrees that information should be accurate and strives to provide accurate information. When errors are detected, Fleet Management promptly reports these errors and resolves them immediately. Fleet Management will evaluate the invoice pending process as it relates to inventory count and update procedures as needed."*

## 6) Count adjustments exceeded expectations for a perpetual inventory system.

A perpetual inventory system is highly dependent on the timeliness and reliability of the information being submitted. The integrity and value of the system requires the active and accurate tracking of inventory.

As a result of the physical count performed on the parts room for Davis Boulevard on September 28, 2016, Fleet made a net negative adjustment to inventory of $3,361.71, excluding bulk items whose use is subject to estimation. Upon further review by Fleet staff, $2,469.44 of that adjustment was related to items that were removed from inventory, but still needed to be costed out to repair work orders. An additional $839.87 of that adjustment was related to inventory items that were "misplaced" and subsequently returned to inventory.

The adjustments to add back misplaced inventory items were not included in total inventory reported to the Clerk's Finance Department. As a result, inventory was understated by $839.87.

During the count, Fleet staff also identified several items that needed to be costed out to repair work orders, including miscellaneous parts for a Menzi mower and a bottle of Loctite. Fleet staff performing the count did not make count adjustments for the items, but instead instructed staff from the Davis Boulevard location to properly charge the items out to the related repairs. The inventory items were not charged out prior to fiscal year-end and as a result, reported inventory was overstated by $842.15.

During the physical count performed at Davis Boulevard, there was a total of 63 items not found during the initial counts, excluding bulk items that were intentionally passed over until later stages of the count. This is approximately 12% of total inventory items reported for the Davis Boulevard parts room. As indicated above, this was primarily related to inventory being out of place and to repair charge outs not being completed in a timely manner or effectively tracked.

Misplaced inventory may lead to overstocking, thus increasing carrying costs and obsolete inventory, while unnecessarily increasing Fleet's exposure to theft and fraud.

As a result of the physical count performed on the parts room for Radio Road on September 27, 2016, Fleet made positive adjustments related to standard non-bulk inventory items totaling $4,789.03. A positive adjustment of this magnitude would be considered unusual under a perpetual inventory system as inventory intake and the related documentation is relatively basic and simple to track.

Internal Audit reviewed parts invoices of $250.00 and above received between September 15, 2016 and October 31, 2016, and was unable to tie any of the positive inventory adjustments to pending invoices. It appears that the inventory items were understated because they were not correctly recorded at the time of receipt.

### Recommendations:

- Fleet Management should ensure that all inventory corrections and adjustments are made before submitting totals to the Clerk's Finance Department for inclusion in the County's comprehensive annual financial reports.
- Fleet staff for the Davis Boulevard parts room needs to significantly improve inventory organization. Any inventory removed from its reported location needs to be accounted for and actively tracked to avoid unnecessary count adjustments and delays.
- Fleet staff for the Davis Boulevard parts room needs to ensure that inventory used in repairs and other jobs is costed out in a timely manner.
- Fleet staff for the Radio Road parts room needs to ensure that inventory receipts are recorded correctly and in a timely manner.

### County Management Response:

*"Fleet Management agrees that information should be accurate and strives to provide accurate information. When errors are detected, Fleet Management promptly reports these errors and resolves them immediately. Fleet Management does not intentionally submit any erroneous reports to the Clerk's Finance Department; however if an*

*error is later noted, a correction will be submitted even if not timely. Significant effort has been made to improve inventory organization and control at the Davis Boulevard shop, along with staff training. Significant challenges of that shop are building space and configuration that make inventory organization and control more difficult."*

# Other Observations: Career and Pay Incentive Policy

In response to concerns raised by the Clerk's Finance Department, Internal Audit performed additional procedures on the application of Fleet's Career and Pay Incentive Policy, specifically with regards to the tool allowance for automotive technicians and the reimbursement of career development testing costs.

Additional procedures included, but were not limited to:

- Reviewing Fleet Management Division's Career and Pay Incentive Policy;
- Reviewing a tool allowance tracking schedule provided by Fleet staff for fiscal year 2016;
- Examining supporting documentation for tool allowance purchases; and
- Examining supporting documentation for career development testing cost reimbursements.

## 1) Tool allowance policies and procedures require attention.

Fleet's Career and Pay Incentive Policy states that tool allowances may be paid to automotive technicians in amounts determined each fiscal year depending on the availability of funds. Tools purchased in accordance with the tool allowance are the personal property of the technician, but must always be available when that technician is performing work for the County. The tool allowance starts after completion of a technician's probationary period or when approved by the Director. The tool allowance stops when a technician submits their resignation or when the County decides to terminate employment, unless otherwise approved by the Director. Unused balances at the end of the fiscal year do not roll forward.

Per email inquiry of the Fleet Maintenance Supervisor by the Clerk's Finance Department, the tool allowance for fiscal year 2016 was $450.00.
An examination of Fleet's tool allowance tracking schedule for fiscal year 2016 and supporting documents for tool allowance purchases resulted in the following observations:

- There is no distinct difference between tools purchased under an employee's tool allowance or tools purchased for general use as "shop tools" other than the concept of ultimate ownership. As such, thorough documentation of all tool purchases is critical. Several occasions were noted where documentation was insufficient to properly and efficiently allocate tool allowance items.
- Except in instances where a tool purchase is made directly by the employee, there is no documentation provided that a tool allowance item was ordered or received by the employee whose allowance is being charged.
- One instance was documented where a tool allowance item did not flow through to Fleet's tool allowance tracking schedule. The specific item did not result in an overage, but inaccurate records increase the risk that improper expenses will be approved.
- Shipping allocations on tool allowance purchases appear to be arbitrary. On one occasion, Fleet allocated shipping costs based on an employee's remaining allowance, with the balance of shipping costs going against another employee's allowance. Arbitrary cost allocations might result in the appearance of bias.
- One instance was noted where an employee used up his tool allowance just prior to turning in his two weeks' notice. While this is not a specific violation of the policy, the system was used in a manner that almost exclusively benefited the employee, which is not the intent of the policy. On the same occurrence, the employee purchased a one-year "Club Membership" to a tool supply company that entitles the cardholder to discounts on future purchases. This item offers no future benefit to Fleet and may not be a reimbursable expense.
- Fleet is providing a tool allowance to the Fleet Maintenance Supervisor, which is not specifically permitted by the policy.

**Recommendations:**

- Fleet Management needs to dramatically improve documentation for tool purchases to allow for efficient and proper tracking of allowances.
- "Shop tools" are County property and should be segregated from allowance tools and separately tracked.
- When a tool is purchased by a manager on behalf of an employee, documentation should be kept that the employee wanted and ultimately received the tool.
- Fleet Management needs to maintain accurate and up-to-date records to ensure that tool allowances are not exceeded.
- Tool allowance should be taxable if employees keep purchased tools.
- Fleet Management needs to develop or define a fair and reasonable allocation policy for shipping costs to avoid the perceived appearance of any bias. Using another employee's allowance may overstate/understate budgeted allocations for financial reporting purposes.
- Fleet Management may want to amend the policy to avoid paying for tools from which they will receive little to no benefit.
- Fleet should seek reimbursement for the "Club Membership" cost if it is deemed to be an invalid County expense.
- Fleet Management should follow the policy in place or amend the policy to permit individuals other than automotive technicians to receive a tool allowance.

**County Management Response**:

*"As a result of this review, Fleet Management will evaluate the tool allowance policy and will revise as needed. County-owned tools and equipment are tracked and inventoried separately."*

## 2) Career development testing reimbursement policies and procedures require attention.

Fleet's Career and Pay Incentive Policy states that the Division will reimburse the costs of all career development testing after tests are successfully passed. This reflects a change in policy and has an effective date of December 1, 2015. Prior to this change, Fleet's policy was to reimburse an employee for their first attempt at a test, pass or fail. Any retesting costs were the employee's responsibility.

An examination of supporting documents for career development testing reimbursements resulted in the following observations:

- Four instances were found where an employee was reimbursed twice for the same test. In all four instances the first unsuccessful attempt was reimbursed under the prior policy and the subsequent pass was reimbursed under the current policy.
- The National Institute for Automotive Service Excellence (ASE) professional certification group only charges testing fees on a maximum of three recertification exams per registration session. The assignment of fees by Fleet in cases where there are three exam fees and more than three recertification tests appears to be arbitrary. Two instances were noted with virtually identical circumstances including multiple (more than three) recertification exams, only one of which was ineligible for reimbursement. In one instance, Fleet assigned a fee to the ineligible test and denied reimbursement for one of the three recertification exam fees. In the other instance, Fleet did not assign a fee to the ineligible exam and the employee was reimbursed for all three recertification exam fees.
- One instance was identified where a County p-card was used to pay two exam fees. There was no documentation on file to support a passing grade for either of the exams.

**Recommendations:**

- Care needs to be taken to ensure that all costs are eligible for reimbursement before being approved for payment. It is expected that this will be much less of an issue going forward under the current policy of reimbursing only successful test results.

- Fleet Management needs to develop or define a consistent fee assignment policy to avoid the appearance of any bias. Management will need to assign priority to either the eligible or ineligible tests and be consistent in their application.
- Fleet should not allow employees to charge testing fees to County p-cards because there is no guarantee that the test will be passed, which is now a requirement for reimbursement.

**County Management Response**:

*"Fleet Management reviewed and revised the testing reimbursement policy prior to this audit and these findings appear to have been caused by the timing differences between the two policies. Fleet Management will re-evaluate the current testing reimbursement process and will revise as needed."*

# Conclusion

Fleet Management maintains an ongoing, up to date perpetual inventory system. However, failure to properly record inventory purchases and inventory usage or disposal in a timely manner significantly limits the effectiveness of a perpetual inventory system and leads to inventory tracking and reporting errors.

Additional comprehensive written policies and procedures would enhance inventory management and the reliability of inventory information while reducing the risk of fraud, error and misappropriation of County assets.

Audits do not relieve management of its responsibilities. It is the responsibility of County management to understand and implement the proper procedural controls in order to reduce and limit the risk of fraud, error, and misappropriation of County assets/revenues. Internal Audit may recommend improvements, but ultimately it is the duty and decision of County management to formulate processes and controls that ensure compliance with applicable rules and regulations.

**County Management Response**:

*"The Fleet Management Division makes property accountability one of its top priorities. With hundreds of parts transactions each day, an occasional error will occur. Most errors are detected in a timely manner through our daily work order reviews, vendor invoice reconciliations, and daily data automation reports. Others are detected later on monthly random inventories or annual inventories. In any case, when errors are discovered, action is taken immediately to resolve the errors, determine the circumstances, and revise procedures if needed. As always Fleet Management appreciates the audit recommendations where improvements can be made. All suggestions and comments will be evaluated for cost effectiveness and efficiencies throughout the organization."*