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INVENTORY AUDIT (JUNE 2016)

AUGUST 2016

DURHAM



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AUDIT SERVICES DEPARTMENT

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assurance and investigative services”*

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To: Audit Services Oversight Committee
From: Germaine F. Brewington, Director
Audit Services Department
Date: August 22, 2016
Re: Inventory Audit (June 2016)

The Department of Audit Services completed the report on the Inventory Audit (June 2016) dated August 2016. The purpose of the audit was to determine if the inventory value recorded on the City's general ledger was fairly stated as of June 30, 2016.

This report presents the observations and results of the Inventory Audit (June 2016) dated August 2016.

The Department of Audit Services appreciates the contribution of time and other resources from employees of the Department of Fleet Management, the Department of Water Management's Divisions of Plant Engineering & Maintenance, Water & Sewer Maintenance, Water Supply & Treatment and Water Reclamation Facilities in the completion of this audit.

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BACKGROUND INFORMATION

Annually, the Audit Services Department conducts an audit of the City's yearend inventory procedures and valuation. Historically, departments are chosen based on the total recorded value of their inventory. The emphasis of this audit is to determine if the inventory value recorded on the City's general ledger was fairly stated as of June 30, 2016.

Each department utilizes its own unique inventory system. These systems included purchased computer software programs (Faster, NexGen and CityWorks) or spreadsheet applications. The Finance Department adjusts the inventory valuation recorded on the City's general ledger at yearend based on the physical inventory count.

The City values its inventories using the weighted average cost method, which approximates the first-in, first-out method. The value of the City's inventory as of June 30, 2016 was approximately \$2,379,132 compared to \$2,362,434 as of June 30, 2015.

The Departments or Divisions selected for the June 30, 2016 inventory observation and valuation were as follows:

- Fleet Management Department
- Water Management Department – Plant Engineering & Maintenance Division
- Water Management Department – Water Supply & Treatment Division (Brown WTP & Williams WTP)
- Water Management Department – Water Reclamation Facility Division (North Durham & South Durham)
- Water Management Department – Water & Sewer Maintenance Division

EXECUTIVE SUMMARY

Purpose

The Audit Services Department performed this audit to determine if the inventory value recorded on the City's general ledger as of June 30, 2016 was fairly stated.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

The inventory value reported on the City's general ledger was fairly stated as of June 30, 2016.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The objectives of the audit were to determine if the inventory value recorded on the City's general ledger was fairly stated as of June 30, 2016 and to determine if the procedures used to value the inventory were adequate.

Scope

The scope of this engagement included: 1) verifying the inventory valuation recorded on the City's general ledger as of June 30, 2016; and 2) evaluating the adequacy of internal controls over the inventory count performed by each department or division.

Methodology

To accomplish the objectives of this audit, audit staff performed the following steps:

- Interviewed appropriate personnel with respect to procedures used in counting and valuing inventory at yearend;
- Randomly selected a sample of inventory items at each location; and verified the number of units on hand using physical inspection;
- Randomly selected a sample of items from the floor and verified that they were reported in the inventory list;
- Randomly selected a sample of items at each location and verified the per unit costs using invoices or other documents;
- Randomly selected a sample of items at each location and recalculated the extensions and footings included on the inventory reports; and
- Traced and agreed the department and division totals per the inventory reports to the final June 30, 2016 general ledger.

During the audit, the staff also maintained awareness to the potential existence of fraud.

AUDIT RESULTS

As required by generally accepted accounting principles, the City of Durham reports in its Comprehensive Annual Financial Report (CAFR) the value of its inventory at yearend. The inventory consists of certain materials and supplies used in maintaining the City's facilities, infrastructure, fleet, fuel, postage, communication equipment, and print shop supplies. The inventory balance as of June 30, 2016 was \$2,379,132 compared to \$2,362,434 as of June 30, 2015.

Following are the detailed results for each department or division.

Fleet Management Department

On June 30, 2016, the Audit Services staff visited the Fleet Management Department to review their inventory procedures and to verify the valuation of their inventory. Audit staff interviewed personnel at the department and discussed the inventory procedures performed. The Fleet Management Department staff utilized the purchased software program "Faster"; and they utilized the perpetual inventory functionality of the software.

The Fleet Management Department inventory consisted of 2,284 parts valued at \$427,963. Audit Services staff randomly selected 117 parts from the inventory sheet and verified the number of units recorded to the physical units on hand with no exception. In addition, 16 items were selected from the floor and traced back to the inventory sheets to ensure inventory recorded was complete. Audit staff also selected 15 items to verify the per unit costs. No exceptions were noted. The division had adequate controls in place when performing the inventory count.

Water Management-Water Supply & Treatment and Water Reclamation Facility Divisions

Water Management's Water Supply & Treatment and Water Reclamation Facilities Division inventory was valued at \$396,453 on June 30, 2016. Personnel from the Audit Services Department visited the Brown, Williams, North Durham, and South Durham Treatment Facilities to review and discuss their inventory procedures and to verify the valuation of their inventory. The inventory value recorded on the general ledger was adjusted at yearend to agree with the actual amounts on hand at yearend. It would not be practical for these treatment facilities to maintain a perpetual inventory system. Each of the facilities maintains approximately a dozen individual chemicals and lubricants. Audit staff verified the unit count of all items included in their inventories. No exceptions were noted. The treatment facilities had adequate controls in place when performing the inventory count.

Water Management-Water & Sewer Maintenance

Water Management's Water & Sewer Maintenance Division inventory consisted of approximately 595 items valued at approximately \$672,485. Audit staff randomly selected 65 items from the inventory sheet and verified the number of units recorded to the physical units on hand with a few immaterial exceptions. In addition, audit staff selected some items from the floor in order to verify that these items were included in the inventory listing. Exceptions were noted. Per Water Management Department staff, items valuing approximately \$55,000 were tracked separately and not reported as part of the yearend inventory. In addition, inventory left over from completed projects by contractors was also not reported as part of yearend inventory. The impact as a result of not including these items in inventory was immaterial to the overall inventory value.

Water Management-Plant Engineering & Maintenance

On June 30, 2016, the Audit Services staff visited Water Management's Plant Engineering & Maintenance Division to review and discuss their inventory procedures and to verify the valuation of their inventory. The inventory consisted of approximately 3,036 items valued at approximately \$727,935 on June 30, 2016. The audit staff randomly selected 30 items from the inventory list to verify the units recorded to the actual units on hand. The dollar value of the sample selected equaled approximately 44% of the total Plant Engineering & Maintenance Division inventory. In addition, staff selected 26 items from the floor to verify the units recorded with no exceptions. Audit staff also randomly selected 8 items to verify per unit cost. No exceptions were noted. The division had adequate controls in place when performing the inventory count.

RECOMMENDATIONS

No recommendations.