

INTERNAL AUDIT OFFICE
CHARLES COUNTY GOVERNMENT

AUDIT REPORT



Charles County Government • 200 Baltimore Street, La Plata, MD 20646
Auditor@CharlesCountyMD.gov • 301-645-0644
Maryland Relay: 7-1-1 (TDD: 1-800-735-2258) • www.CharlesCountyMD.gov

Inventory Audit

DEPARTMENT/DIVISION:

Department of Public Works,
Fleet and Inventory Management

REPORT NUMBER:

2023-DPW-005

REPORT DATE:

02/15/2024



Charles County Internal Audit Office

AUDIT OF DEPARTMENT OF PUBLIC WORKS - FLEET & INVENTORY MANAGEMENT: INVENTORY AUDIT

Report Number:

2023-DPW-005

Report Date:

02/15/2024

Director of Department of Public Works, Internal Audit Oversight Committee, County Administrator & Deputy County Administrator:

In accordance with the Internal Audit Charter, SOP# CP.CAD.04.001, the Internal Audit Office (IAO) performed an audit of the Department of Public Works – Fleet & Inventory Management: Inventory Audit. This audit was conducted as part of the IAO’s risk-based Annual Audit Plan approved by the Internal Audit Oversight Committee for FY24. Internal Audits are designed to provide assurance, add value, and improve operations.

The audit’s objectives were to: 1. Verify the physical existence of recorded inventory items; 2. Ensure inventory transactions are accurately recorded and traceable; 3. Verify that inventory is adequately and appropriately stored and secured; 4. Identify discrepancies or inefficiencies in the inventory management process; 5. Assess the effectiveness of existing internal controls of inventory management; and 6. Determine if a consistent process exists between the multiple divisions in DPW for inventory and capital assets.

The results of the audit, findings and recommendations for improvement are detailed in this report. We would like to thank the members of management for their teamwork and cooperation during the audit. Management was provided with an opportunity to respond to this report and their response is included.

Sincerely,

Johnnie Coleman, Senior Internal Auditor

CONCLUSIONS

The IAO’s conclusion, based on the evidence obtained, is that the Department of Public Works – Fleet and Inventory Management: Inventory Integrity is **GENERALLY EFFECTIVE**¹. This assessment is based on the strengths and weaknesses of the entities’ business operations as they relate to the audit objectives.

BACKGROUND & SCOPE

Background

The Department of Public Works (DPW) provides crucial services that improve the quality of life for the residents of Charles County and ensures County infrastructure and assets are safe and reliable. DPW is comprised of two main divisions, Facilities and Utilities, each of which is further divided into 4 subdivisions.

As a subdivision of DWP Facilities, Fleet and Inventory Management (F&IM) is responsible for ordering, receiving, tracking, and issuance of a wide range of supplies and materials. Under management of F&IM, a warehouse containing approximately 450K in auto parts and general supplies, field storage containing approximately 250K in road pipe, two salt domes containing approximately 700K in road salt, and 7 commercial fuel tanks across 4 sites that dispense approximately 750,000 gallons annually. Other duties of F&IM include providing registration, titling, and maintenance for 646 tagged and 682 non tagged vehicles (excluding 43 VanGo vehicles and 55 Landfill vehicles over 1 Ton).

Potential risks as it relates to F&IM Inventory Management include operational risks such as processing errors, efficiency risks, and fraud risks such as theft. Based on the Internal Audit Office's November 2022 risk assessment, the Internal Audit Oversight Committee agreed, as part of the FY 2023/24 Audit Plan, that it was prudent to conduct an internal audit of inventory.

Scope

The scope of this audit primarily centered on evaluating inventory systems and processes, encompassing a comprehensive review of current warehouse inventory as well as a retrospective analysis of inventory spanning the past 12 months.

The audit objectives were identified by conducting a risk-based analysis of the general business processes of F&IM as it relates to inventory management:

- Verify the physical existence of recorded inventory items.
- Ensure inventory transactions are accurately recorded and traceable.
- Verify that inventory is adequately and appropriately stored and secured.
- Identify discrepancies or inefficiencies in the inventory management process.
- Assess the effectiveness of existing internal controls of inventory management.
- Determine if a consistent process exists between the divisions in DPW for inventory and assets.

The Internal Audit Office's audit approach involved testing audit objectives through evidence-analysis techniques, including reviewing department SOPs, interviewing personnel, conducting

site visits, inventory checks, and document tracing. Detailed audit methods and procedures can be found in the methodology section of this report.

DISCUSSION, OBSERVATIONS, FINDINGS & RECOMMENDATIONS

Inventory Process Between Departments & Divisions within DPW

Discussion

An objective of the audit was to determine if consistent inventory management process exist within divisions of DPW or across departments countywide. In sum, F&IM serves as a centralized hub with software for managing a warehouse of stocked general supplies and vehicle parts, salt dome storage, and vehicle maintenance orders. While F&IM's warehouse stock primarily serves divisions within DPW, any County division can utilize inventory services or stock located at the warehouse. F&IM coordinates any cross-departmental distributions and works to ensure financial accountability for items distributed.

The audit revealed that while F&IM provides common inventory, some divisions within DPW and Departments throughout the County maintain their own inventories for a variety of reasons. This is the result of specialized inventory needs, convenience of physical location, or space considerations. The scope of this audit focused only on F&IM inventory management. During the audit's entrance conference, DPW's senior leadership acknowledged commitment to future internal discussions regarding a structural review of various inventories across DPW.

Physical Inventory - Capital/Controlled Asset Disposal Transfer Form

Discussion

F&IM conducts annual physical counts in which inventory is adjusted for obsolescence, damage, and/or shrinkage and the inventory software is adjusted accordingly. The County procedure for disposal of obsolete items is to complete a Capital or Controlled Asset Disposal Transfer Form.

Finding #1: It was found that F&IM last completed a disposal of obsolete items in 2016. The auditor notes that before disposing of something, FIM first works to return items which may reduce the need for a Capital or Controlled Asset Disposal Transfer Form.

Recommendation #1: Purging obsolete items via a Capital or Controlled Asset Disposal Transfer Form should be done on an annual basis to co-inside with the Annual Physical Count. Incorporate this procedure into the F&IM Inventory Control Operating manual.

Traceability of Transactions – Monthly Inventory Reports

Discussion

Any County staff may request stock from warehouse inventory. When an item is disbursed, F&IM staff records the transaction and staff member's employee ID in the inventory software for monitoring and divisional billing. To monitor inventory disbursements, F&IM generates and disseminates Monthly Inventory Reports to the financially responsible departments/divisions, detailing the employees who obtained specific items and the associated billing accounts. These reports serve as a critical control measure, ensuring that disbursed items are independently verified by the receiving division. They also enable division managers to effectively monitor appropriate inventory usage of their staff.

Finding #2: Monthly Inventory Reports are distributed to other departments/divisions as a hard copy report and are not required to be reviewed or approved by other department/division managers. Without a formal acknowledgment from the other department/division management, it becomes challenging to ensure that the reported items were duly reviewed and approved, potentially compromising the control and oversight of the inventory management process.

Recommendation #2: It is recommended to implement a formal review process and mandatory sign-off of the Monthly Inventory Reports by divisional management. Send the reports electronically for documentation and clearly define review criteria to ensure effective evaluation. Conduct training sessions to familiarize division management with the revised review process, emphasizing the importance of their role in overseeing inventory reports. Incorporate this procedure in the F&IM Inventory Control Operating manual.

Storage & Security of Inventory

Observation: During the audit, it was observed that fire suppression is not installed in a part of the warehouse that was extended to store parts, supplies, batteries, chemicals, signs, etc. This storeroom also contains hundreds of cardboard filing boxes containing records for County departments. In discussion with DPW's Chief of Buildings and Trades, the warehouse extension was built to code and permitted with compliance at the time of construction. The original intent of the building was to be for storage of DPW parts, signs etc. Over time, out of necessity, the building's use may have expanded beyond its original intent. Construction of a new storage facility is on the horizon but may take years. If it is found to be prudent by management, a dry fire suppression system could be installed. **No response provided by F&IM management.**

MANAGEMENT RESPONSE

Management is provided with the opportunity to respond to recommendations and their responses are summarized below. It is important to note that auditors don't implement recommendations as their role is investigative and advisory, lacking the managerial authority to enforce change. Management, on the other hand, holds the responsibility for implementation due to their authority over resources, decision-making, and strategic direction toward goals and objectives, making them accountable for addressing identified issues. As such, management may also have a valid rationale for existing processes or alternatives to audit recommendations.

Management Responses Provided by: Deputy Director, Public Works – Facilities

Management's Response Recommendation 1:

The current practice is effective and is documented in the Inventory Control Operating Manual. The inventory team purges obsolete items and prepares the appropriate forms as needed, which is extremely rare. The Inventory Program Manager actively monitors items and discontinues stocking items that are slow moving or for which the demand is expected to become minimal. In addition, the Inventory Program Manager aggressively pursues opportunities to return items to vendors rather than to dispose of items.

Management's Response Recommendation 2:

There is a tight timeframe to complete the month end process because the following month in the Computer Fleet Analysis Software (CFA) cannot be opened until the prior month is closed. Any delay in the month end process extends the amount of time the inventory team is manually recording transactions for the next month. Therefore, F&IM tries to close the prior month as close to the beginning of the following month as possible. During the month, the inventory team records items to the account numbers provided by the departments/divisions. The team should not be held responsible for determining if the account number provided by the department/division is accurate. The risk that an account number is incorrect should be low as it was the account number provided by the department/division. Also, the risk of the team not recording or incorrectly recording a transaction because it is from manually recorded data significantly outweighs concerns regarding the accuracy of the account number provided by the department/division.

The CFA's "monthly detail report" for all transactions is not user-friendly or beneficial for F&IM and departments/divisions. As a result, F&IM generates CFA's "monthly summary report" and

then only generates a detail report for accounts with activity for the month. F&IM generates 30 to 40 detail reports each month. After month end is closed in CFA, the detail reports are sorted by department/division and packaged with the monthly fuel reports for distribution to departments/divisions. Since inventory disbursements are recorded through journal entry to Munis, the department/division works with the Accounting Department for any adjustments. Every department/division is responsible for ensuring invoices or transactions recorded in Munis to their expense accounts are accurate and has their own process to follow to accomplish that review/reconciliation. The current practice is effective and allows F&IM to provide each department/division with the relevant information for their department/division. F&IM explored saving electronic files of the summary report and detail reports from CFA, but determined it is not straightforward, and will increase the amount of time needed to finalize the month end process. F&IM also finds the hard copies easier to review, especially for transactions that impact multiple accounts. Therefore, unless F&IM identifies a method to substantially reduce the number of detail reports and is user-friendly for departments/divisions, F&IM plans to continue printing and distributing hard copies of the reports.

METHODOLOGY

Audit objectives were selected by the Internal Audit Office to evaluate F&IM’s general business functions as it relates to inventory management. The audit approach included procedures to test audit objectives. IAO audit procedures included evidence-analysis techniques based on reviewing department SOP’s, interviewing personnel, conducting site visits, inventory checks, and document tracing. The table below connects the general auditing procedures used to evaluate the audit objectives.

| Business Function: Inventory Management | |
|--|---|
| Audit Objectives | Audit Procedure(s) / Testing |
| Verify the physical existence of recorded inventory. | <ul style="list-style-type: none"> • Conducted physical inspection comparing recorded inventory to actual inventory. • Traced paid invoices from accounts payable to evidence of items being accounted for in the Computerized Fleet Analysis Software. |
| Ensure inventory transactions are accurately recorded and traceable. | <ul style="list-style-type: none"> • Analyzed and evaluated procedures of warehouse inventory lifecycle for design and effectiveness. • Assessed monthly reports for this design and effectiveness as a control. |
| Verify that inventory is adequately and appropriately stored and secured. | <ul style="list-style-type: none"> • Conducted onsite visit to observe adequacy of storage parameters. |
| Identify discrepancies or inefficiencies in the inventory management process. | <ul style="list-style-type: none"> • Reviewed and analyzed unit procedures and observations throughout the audit process. |
| Assess the effectiveness of existing internal controls of inventory management. | <ul style="list-style-type: none"> • Reviewed and analyzed unit procedures and observations throughout the audit process. |
| Determine if a consistent process exists between the multiple divisions in DPW for inventory and assets. | <ul style="list-style-type: none"> • Interviewed key staff and document how FIM interacts with other Division. |

Internal Controls

Internal controls can be defined as any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Implementation of recommendations noted in this report will strengthen controls. In all elements of the audit procedures, the auditor evaluates the design and effectiveness of controls. If deficiencies in design or effectiveness are noted, it is reported as a finding in this report.

Conformance - Professional Practice of Internal Auditing

The audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Additionally, this audit was conducted with the independence to carry out the internal audit responsibilities in an unbiased manner. We approached the audit process with an unbiased mental attitude, focusing solely on the facts and evidence at hand, thereby upholding the principles of objectivity. Internal audits are designed to provide assurance, add value, and improve operations.

| Report Distribution: | Audit Team: |
|--|--|
| Martin Haris, Director, Department of Public Works Terri Kahouk, Deputy Director, Department of Public Works - Facilities John Mudd, Chief, Fleet and Inventory Management | Johnnie Coleman, CIA Senior Internal Auditor Michael Pheulpin, M.S. Junior Internal Auditor |

ⁱ Definitions:

Effective: The design and effectiveness of the internal control environment address key risks. The business unit complies with external laws and regulations, and internal policies, procedures, and guidelines. Business processes are managed effectively resulting in reliable achievement of expected outcomes.

Generally Effective: The design and effectiveness of the internal control environment generally address key risks; however, findings indicate that some minor areas of weakness in the control environment need to be addressed. Isolated instances of non-compliance with external laws and regulations, and internal policies, procedures and guidelines may exist. Business processes may lack effectiveness or not be managed effectively in all areas resulting in reduced achievement of expected outcomes.

Ineffective: The design and effectiveness of the internal control environment does not address key risks or does not exist. Non-compliance or historical patterns of non-compliance with key regulatory requirements and internal policies, procedures and guidelines exist which expose the audited entity to financial, reputational, and operational risks. Business processes are not managed effectively and expected outcomes are not achieved.