



# Inventory Controls Audit

April 5, 2024

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Mattie Parker

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The Inventory Controls Audit was conducted as part of the Department of Internal Audit's Fiscal Year 2023 Annual Audit Plan.

### Audit Objectives

The objectives of this audit were to:

- evaluate the effectiveness and efficiency of controls over inventories; and,
- verify general ledger balances.

### Audit Scope

Our audit included the period October 1, 2021 through June 30, 2023. Activity beyond this period was reviewed as deemed necessary.

### Opportunities for Improvement

Lack of documented standard operating procedures

Inventory counts less frequent than what is required by the City's Financial Directives

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## Executive Summary

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As part of the FY2023 Annual Audit Plan, the Department of Internal Audit conducted an audit of Inventory Controls. Our audit focused on inventory managed by the Wastewater Division of the Water Department, the Fire Department, and the Purchasing Division of the Financial Management Services Department.

We concluded that physical controls over inventory, managed by the Water Department's Wastewater Division (specifically the Village Creek Water Reclamation Facility) and the Fire Department, are effective. For example, physical safeguards restrict access into the Village Creek Water Reclamation Facility and Fire Department warehouses. Also, systematic controls within Maximo and PeopleSoft help prevent unauthorized system access. The results of our audit noted that the majority of the Purchasing Division's inventory was for digital, versus physical inventory.

We did, however, conclude that the Fire Department and the Purchasing Division did not have established standard operating procedures governing inventory controls. In addition, the frequency by which the Water Department conducted physical inventory counts at the Village Creek Water Reclamation Facility was not aligned with City of Fort Worth Financial Directives.

No issues were identified when reviewing inventory balances and related year-end adjustments.

Our audit findings are discussed in further detail within the [Detailed Audit Findings](#) section of this report.



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## Background

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In planning for this Inventory Controls Audit, Internal Audit selected inventories managed by the Wastewater Division of the Water Department, the Fire Department, and the Purchasing Division of the Financial Management Services (FMS) Department. These inventories were selected for audit based on the materiality of general ledger inventory balances, our assessment of feedback obtained from discussions with management, and time since the last inventory audit.

### **Wastewater Division of the Water Department**

Water Department inventory was selected for audit due to the materiality of general ledger inventory balances. For instance, at June 30, 2023, Wastewater Division inventory accounted for 29.28% of the total Enterprise Fund general ledger balance (\$1,584,566.20 of \$5,411,806.33). Also, since Internal Audit released a Water Field Operations Inventory Audit on November 6, 2020, we selected inventory managed by the Wastewater Division for this audit.

The Wastewater Division's website indicates that the Village Creek Water Reclamation Facility provides wastewater treatment for most of Fort Worth and 23 neighboring communities. The Wastewater Division manages a warehouse of inventory that includes:

- parts (e.g., motors, pumps, and meters);
- tools (e.g., saws and brushes); and,
- consumables (e.g., batteries and safety equipment).

The Wastewater Division has several controls in place to help ensure the security of inventory items. For example, the wastewater treatment plant has a gated entrance and perimeter fence that surrounds the facility. Also, surveillance cameras are installed inside and outside of the perimeter fence, while facility entry is managed by a keypad-controlled front entry gate and security guards. In addition, management maintains keys for entry and key log information. Each of these measures help ensure the facility is accessed only by authorized personnel.

Inventory documentation indicated that, at June 30, 2023, the Wastewater Division had 3,838 active and 329 obsolete inventory items stored at the warehouse. These inventory items remain in inventory until issued to staff for City use. Some obsolete inventory is retained as needed for repairs to old equipment, old infrastructure, etc.

Wastewater Division warehouse staff conduct physical inventory counts once per year, during the fiscal year-end period. Those physical counts are recorded in Maximo, and sent to the FMS Department for proper accounting and recording.

The Wastewater Division uses Maximo software to help manage and track inventory. Within Maximo, staff initiate inventory purchases, document the receipt of inventory and physical inventory count results, and record and execute work orders that document and account for inventory issuances.

### **Fire Department**

The Fire Department's inventory was selected for audit due to the lack of standard operating procedures. The Fire Department's inventory warehouse (adjacent to the City's fire truck repair depot in south Fort Worth) maintains an inventory that includes professional protective gear and tools, as well as cleaning, office, kitchen and medical supplies. Fencing and three gates surround the fire truck repair depot and two of four sides of the warehouse.



Entry into the inventory storage room requires a special key that management indicated could only be duplicated by the key company, further reducing risk of unauthorized entry. Front and back entry doors have a security alarm with passcode pads, and windows have bars to protect against unauthorized entry.

Inventory documentation indicated that, at June 30, 2023, the Fire Department had 637 different inventory items stored at the warehouse. The Fire Inventory and Commissary general ledger inventory accounts reflected balances of \$687,942.64 and \$290,195.64, respectively. These inventory items remain in inventory until issued to City staff for City use.

The Fire Department manages and tracks inventory within PeopleSoft's Supply Chain Management module. Within PeopleSoft, Fire Department staff record inventory purchases, the receipt of inventory, and physical inventory counts that are conducted the last full week of each quarter. The FMS Department's general ledger team processes a year-end adjustment based on the Water Department's final physical inventory count of the year.

#### **Purchasing Division of the Financial Management Services Department**

Postage inventory was selected because at June 30, 2023, the Postage Inventory general ledger account reflected a balance of \$86,901.78. Of that amount, physical inventory totaled only \$24.42. The remaining \$86,877.36 was for digital prepaid postage. Management indicated that a majority of the inventory is virtual inventory funds stored in shipping partner accounts.



## Objectives

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The objectives of this audit were to evaluate the effectiveness and efficiency of controls over inventories, and to verify general ledger balances.

## Scope

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Our audit covered the period October 1, 2021 through June 30, 2023. Activity beyond this period was reviewed as deemed necessary.

This audit was limited to inventories managed by the Wastewater Division of the Water Department, the Fire Department, and the Purchasing Division of the Financial Management Services Department.

## Methodology

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To achieve the audit objectives, the Department of Internal Audit performed the following:

- reviewed written policies and procedures relating to inventory management;
- interviewed Water, Fire, and the FMS Department staff;
- conducted walk-throughs and observed physical inventory counts conducted by management;
- analyzed documentation supporting annual inventory cycle counts;
- analyzed logistical elements within Maximo and PeopleSoft's Supply Chain Management module;
- compared existing controls with City requirements (e.g., Financial Directives and Financial Management Policy Statements); and,
- evaluated internal controls related to inventory.

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, 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.

## **Audit Results**

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### **Village Creek Water Reclamation Facility Warehouse**

During our site visit, we observed multiple controls to safeguard and secure inventory. Examples include physical barriers (e.g., perimeter fence, guarded entrance, and key log) and systematic controls. We did not identify issues related to physical barrier controls. Also, facility badge access restrictions were considered effective.

Internal Audit randomly selected a sample of 20 purchase orders initiated in Maximo. We selected 60% of our random sample from purchase orders totaling \$50,000.00 and above, and 40% from purchase orders totaling less than \$50,000.00. Through the physical matching of purchase order requisitions, receipts, and approvals, we verified that valid segregation of duties protocols existed. Based on our audit fieldwork, we determined that the Water Department managed 3,838 active inventory items, and conducted routine inventory counts to help establish necessary accountability. However, the Wastewater warehouse did not conduct bi-annual physical inventory counts as required by Financial Directive 12 (FD-12). Wastewater management stated that due to staffing issues, they only perform annual physical counts.

### **Fire Department Warehouse**

During our audit, we observed multiple controls to safeguard and secure inventory. Examples include physical barriers (e.g., barbwire fence, gated side entrance, keypad alarm system, non-duplicatable keys, and key log) and systematic controls (e.g., segregated duties). Facility access restrictions at the Fire warehouse were also considered effective.

We concluded that the Fire Department managed 637 inventory items and conducted routine cycle and quarterly physical inventory counts to help establish necessary accountability. However, during our inquiries and site visit, we concluded that the Fire Department did not have written standard operating procedures (SOPs) for inventory management.

### **Purchasing Department Postage Inventory**

Based on our audit fieldwork, the Purchasing Division did not have written SOPs for postage inventory management. In addition, we concluded that postage-specific funds were not classified in PeopleSoft as prepaid assets.

### **General Ledger Balances**

We compared general ledger balances in PeopleSoft to inventory balances in PeopleSoft subledgers and Maximo for FY2020 through FY2022. We concluded that valuation methods were consistent and complied with Generally Accepted Accounting Principles. Additionally, reconciliations were performed to adjust to year-end physical counts.

### **Additional Observations**

It came to our attention during a site visit, that one rooftop skylight cover was loose, which could pose a safety risk. We verbally communicated this observation to Water Department management.



## Overall Risk Evaluation

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High	Medium	Low
	Lack of documented standard operating procedures	
	Inventory counts less frequent than what is required by City Financial Directives	





## Detailed Audit Findings

### 1. There were no documented standard operating procedures for the management of Fire and postage inventory.

Standard operating procedures (SOPs) establish the baseline for a team. The Committee of Sponsoring Organizations (COSO) Standard states that “Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives”. In addition, COSO states that "first line management should build policies and procedures in the control activities".

During our interviews with Fire Department and Purchasing Division management, as well as our review of FMS inventory reconciliation documents, Internal Audit determined that written SOPs for the management of both Fire and postage inventory do not exist. We were informed that Fire Department warehouse management changed during COVID-19 and the departing employee did not leave documentation to support processes and/or procedures. Likewise, in reference to postage inventory maintained by the Purchasing Division, Internal Audit was informed that upon employee turnover, the departing employee left no documentation to support processes and/or procedures.

SOPs are the standard for how work should be done. The lack of SOPs can have a significant impact on a department, such as inconsistent practices, lost quality control, low efficiency, increased training time, and increased risks.

**Recommendation 1A:** The Fire Chief should ensure that written inventory policies and procedures are developed, efficiently communicated, and enforced.

**Auditee’s Response:** Concur. Supply Inventory Procedures Memo will be reviewed, researched and forwarded to Policy Committee and to be formalized into a Standard Operating Procedure (SOP). The SOP will be placed on the department’s SharePoint site for distribution to department personnel

**Target Implementation Date:** April 15, 2024

**Responsibility:** James McAmis, Deputy Chief and James Conner, Fire Supply Captain

**Applicable Department Head:** James E. Davis, Fire Chief

**Responsible Assistant City Manager:** Dana Burghdoff, Assistant City Manager

**Recommendation 1B:** The Chief Financial Officer should ensure that written policies and procedures governing the management of postage inventory are developed, efficiently communicated, and enforced.

**Auditee’s Response:** Concur. The Financial Management Services Department has developed written processes and procedures to ensure compliance with Finance Directive 12 (Inventory). Purchasing will provide Accounting with reconciliations of the Postage inventory twice a year. All variances will be researched and corrected, as appropriate. Written procedures have also been added regarding controls in place over the monthly billing charge to departments for the postage used. This will be implemented in March 2024.

**Target Implementation Date:** Implemented



**Responsibility:** Jo Ann Gunn, Chief Procurement Officer

**Applicable Department Head:** Reginald Zeno, Chief Financial Officer

**Responsible City Manager:** David Cooke, City Manager

**2. Physical inventory counts at the Water Department’s Wastewater Division warehouse were not conducted as required by City Financial Directives.**

Section V.D. of the City’s Financial Directive for Inventory (FD12) states that “Each department must conduct physical inventory counts at least bi-annually to verify inventory account balances in the general ledger accurately represent the actual value of physical inventory. A reconciliation must be completed on a bi-annual basis by the department supervisors and reviewed by the Accounting Department in a timely manner.”

Based on documentation supporting departmental inventory counts communicated to the FMS Department, we concluded that Wastewater management did not perform physical count and reconciliation activities at least twice per year, as required by FD12. Wastewater management stated they did not have enough staff to perform physical count and reconciliation activities twice per year.

Frequent physical and cycle inventory counts, and reconciliations, are good ways to find discrepancies. A lower count frequency could result in a difference between the quantities of inventory items on hand (including those items potentially critical to a department’s daily operations) and what is on file. This difference could result in a misstatement of the inventory value and could adversely impact the department’s business.

**Recommendation 2:** The Water Department Director should ensure that the department’s inventory physical count and reconciliation activities align with FD12. If such alignment is not feasible, then a waiver from FMS regarding FD12 should be obtained.

**Auditee’s Response:** Concur. The Plant Operations Warehouse will conduct physical inventory in April and September. Staff will verify inventory account balances in the general ledger and reconcile any differences in a timely manner.

**Target Implementation Date:** Immediately

**Responsibility:** Water Department, Plant Operations Division (Shannon Dunne)

**Applicable Department Head:** Chris Harder, Water Department Director

**Responsible Assistant City Manager:** Fernando Costa, Assistant City Manager



## Acknowledgements

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The Department of Internal Audit would like to thank the Water, Fire, and Financial Management Services Departments for their cooperation and assistance during this engagement.