
AGREED-UPON PROCEDURES RELATED TO THE CENTRAL STORES PHYSICAL INVENTORY

Office of the City
Auditor

City of San Diego





THE CITY OF SAN DIEGO

DATE: September 8, 2017
TO: Kristina Peralta, Director, Purchasing and Contracting
FROM: Eduardo Luna, City Auditor, Office of the City Auditor
SUBJECT: Agree-Upon Procedures Related to the Central Stores Physical Inventory – FY17

Enclosed is the Agreed-Upon Procedures Related to the Central Stores Physical Inventory for Fiscal Year Ending 2017 conducted by Macias Gini & O'Connell (MGO). This inventory count is required by San Diego Municipal Code §22.0501. The report contains the procedures and results of work completed by the MGO, and is provided for informational purposes only. Your response to the audit is presented after page 8 of this report.

We would like to thank MGO for their work, and the Purchasing & Contracting Central Stores staff for their assistance and cooperation during this audit.

Respectfully submitted,

Eduardo Luna
City Auditor

cc: Honorable Mayor Kevin Faulconer
Honorable City Councilmembers
Honorable Audit Committee Members
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Ron Villa, Deputy Chief Operating Officer, Internal Operations
Rolando Charvel, City Comptroller
Andrea Tevlin, Independent Budget Analyst
Matthew Helm, Deputy Director, Purchasing and Contracting
Thomas Sawade, Stores Operations Supervisor

CITY OF SAN DIEGO

Independent Accountant's Report on Applying
Agreed-Upon Procedures Related to the
Central Stores Physical Inventory

June 30, 2017



Certified
Public
Accountants

CITY OF SAN DIEGO
Independent Accountant’s Report on Applying
Agreed-Upon Procedures Related to the
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Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Office of the City Auditor
of the City of San Diego
San Diego, California

We have performed the procedures enumerated below, which were agreed to by the Office of the City Auditor (City Auditor) of the City of San Diego (City), solely to assist the City Auditor's compliance with the requirements of Article 2, Division 5, Section 22.0501 of the San Diego Municipal Code regarding the City's Central Stores inventory records as of June 30, 2017. The Purchasing and Contracting Department (the Department) is responsible for the City's Central Stores inventory records. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

- 1) Obtain an electronic version of the Central Stores (Store 1 and Store 2) inventory stock records as of June 26, 2017 maintained by the Purchasing and Contracting Department and select a sample, by storeroom, based on a 99% confidence level and 8% confidence interval.

Result: We obtained an electronic version of inventory stock records maintained by the Purchasing and Contracting Department for Store 1 and Store 2, which contained a total of 1,175 and 1,671 stock items, respectively. Per concurrence with the City Auditor at the entrance conference held on June 19, 2017, paper-form stock items were excluded from the sampling population, resulting in a total of 2,592 stock items – Store 1 had 921 stock items and Store 2 had 1,671 stock items. Using a 99% confidence level and 8% confidence interval resulted in a total sample size of 238. The sample size was allocated between Store 1 and Store 2 based on the dollar value of the sampling population (excluding paper-form stock items). We randomly selected 85 stock items from Store 1 and 153 stock items from Store 2.

- 2) Conduct physical inventory counts at the Department's Store 1 and Store 2 location for the randomly selected sample items and compare the results of the physical inventory counts to the Department's inventory stock records. The physical count includes opening a judgmental portion of the inventory boxes for the sample items selected to verify the contents.

Result: Refer to Attachment 1 (which reports the results for both Procedures 2 and 3) for a summary of the results of the physical inventory count and Attachment 2 for a detail listing of the inventory stock item discrepancies.

- 85 stock items were randomly counted at Store 1 with a recorded inventory value of \$54,838. Of the 85 stock items counted, MGO noted discrepancies for 22 stock items. 13 of the stock items resulted in an overstatement of 120 inventory units, or \$539, which were included per the inventory record system but not on hand. 9 of the stock items resulted in an understatement of 141 inventory units, or \$1,445, which were on hand, but not included in the inventory record system. The net impact of items counted at Store 1 is an understatement in the inventory record system of \$906.

- 153 stock items were randomly counted at Store 2 with a recorded inventory value of \$218,743. Of the 153 stock items counted, MGO noted discrepancies for 30 stock items. 24 of the stock items resulted in an overstatement of 587 inventory units, or \$4,483, which were included per the inventory record system but not on hand. 6 of the stock items resulted in an understatement of 52 inventory units, or \$349, which were on hand, but not included in the inventory record system. The net impact of items counted at Store 2 is an overstatement in the inventory record system of \$4,134.

- 3) Judgmentally select 10 items on hand at Store 1 and Store 2 and compare the items to the inventory system stock records to verify if they are accurately recorded in the inventory system.

Result: Refer to Attachment 1 (which reports the results for both Procedures 2 and 3) for a summary of the results of the physical inventory count and Attachment 2 for a detail listing of inventory stock item discrepancies.

- Judgmentally selected and counted 10 stock items on hand at Store 1 with a recorded inventory value of \$47,704. Of the 10 stock items counted, MGO noted discrepancies for 4 stock items. 1 of the stock items resulted in an overstatement of 21 inventory units, or \$42, which were included per the inventory record system but not on hand. 3 of the stock items resulted in an understatement of 34 inventory units, or \$1,171, which were on hand but not included in the inventory record system. The net impact of items counted at Store 1 is an understatement of the inventory record system of \$1,129.
 - Judgmentally selected and counted 10 stock items on hand at Store 2 with a recorded inventory value of \$169,198. Of the 10 stock items counted, MGO noted discrepancies for 5 stock items. 2 of the stock items resulted in an overstatement of 32 inventory units, or \$5,034, which were included per the inventory record system but not on hand. 3 of the stock items resulted in an understatement of 64 inventory units, or \$2,590, which were on hand but not included in the inventory record system. The net impact of items counted at Store 2 is an understatement of the inventory record system of \$2,444.
- 4) Inquire with the Store Manager regarding the Central Stores procedures and activities to ensure obsolete inventory (inventory with no sales to the City departments during the prior fiscal year) is annually reviewed. Verify if the Department's justification for retaining obsolete items is maintained on file, or if obsolete inventory is being properly liquidated.

Result: Per inquiry with the Central Stores Operations Supervisor, obsolete inventory is reviewed annually by the Purchasing and Contracting Department. Stock items in the inventory records without goods movement within the last 12 months are identified in SAP by Central Stores staff. The Purchasing and Contracting Department attaches a listing of items identified from SAP to a memo that is sent to each respective department, requiring their review of the items identified and a response within 30 days. In their response, departments provide justification for retaining obsolete items or disposing of them. Obsolete stock items identified by the departments are removed from the inventory records by Central Stores staff and set aside for disposal.

- 5) Determine if the recommendations from the FY 2016 Inventory agreed-upon procedures have been adequately implemented to resolve the identified issues.

Result: The City was recommended to strengthen procedures to properly liquidate obsolete inventory in a timely manner from the results of the FY 2016 Inventory agreed-upon procedures. Per discussion with the Deputy Director of Purchasing and Contracting during the entrance conference held on June 19, 2017, the annual review for identifying obsolete items during FY 2017 was initiated earlier compared to prior years. Based on our review of the supporting documentation provided, we noted most of the responses received from the City departments were obtained before the entrance conference date. We verified the obsolete items confirmed by the City's departments were removed from the inventory records by Central Stores staff. As such, we believe the City implemented the necessary corrective action as a result of the prior year recommendation.

During the inventory count conducted at Store 1 on June 27, 2017, we observed that all obsolete items noted in the prior year were appropriately segregated in a storeroom location, set apart from the moving stock items.

- 6) Provide the results of the inventory counts by storeroom, and the results of the obsolete inventory review in a draft written report with recommendations, as appropriate, to address any identified issues.

Result: The results of the physical inventory counts for Store 1 and Store 2 were provided to the Department on July 28, 2017.

- 7) Hold an exit conference with Purchasing and Contracting Department staff and City Auditor staff to review and finalize the draft report.

Result: An exit conference was held with Purchasing and Contracting Department staff and City Auditor staff on August 7, 2017 to review and finalize the draft report.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on the Central Stores inventory records maintained by the Department. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the City Council and Audit Committee of the City of San Diego, the City Auditor, and the Purchasing and Contracting Department of the City of San Diego and is not intended to be and should not be used by anyone other than those specified parties.

Macias Gini & O'Connell LLP

San Diego, California
August 9, 2017

Attachment 1

Location	Total Number of Stock Items in Inventory Records¹	Total Inventory Value²	Total Number of Sampled Stock Items³	Total Value of Sampled Stock Items	Number of Inventory Units Over/(Under) in the Inventory Records	Total Value of Inventory Units Over/(Under) in the Inventory Records	Percentage Difference Between the Value of Sampled Items Counted and Total Value of Sampled Inventory as Recorded in the Inventory Records	Estimated Difference in the Total Inventory Value per the Department's Stock Records Based on the Sampling Error
Store 1	1,175	\$ 685,751	95	\$ 102,542	141 (175)	\$ 581 (2,616)	0.57% -2.55%	\$ 3,885 (17,495)
Store 2	1,671	1,097,252	163	387,941	619 (116)	9,517 (2,939)	2.45% -0.76%	26,918 (8,313)
Totals	2,846	\$ 1,783,003	258	\$ 490,483	469	\$ 4,543	0.93%	\$ 4,996

¹The "Total Number of Stock Items" is as of June 26, 2017, based upon the Department's inventory stock records including the various forms maintained in inventory, which were excluded from our sampling population.

²The "Total Inventory Value" is as of June 26, 2017, based upon the Department's inventory stock records.

³The "Total Number of Sampled Stock Items" refers to the number of separate stock items physically counted pursuant to Procedures #2 and #3.

Attachment 2 Store 1 (B Street)

PROCEDURE 2 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Inventory Value (Rounded to Nearest Dollar)	Unit Value (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit of Measure	Number of Units Per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory Value Overstated/ (Understated) in SAP
1	22042610	HANDCUFF CASE BLK LEATHER CHROME SNAPS	\$ 1,330	\$ 25	54	EA	94	(40)	\$ (1,000)
2	22044257	BOWL PLASTIC 32OZ MICROWAVABLE	260	4	68	EA	128	(60)	\$ (240)
3	22014533	CAN SAFETY 5GAL TYPE II JUSTRITE #10821	613	61	10	EA	11	(1)	\$ (61)
4	22040231	BRUSH HD TRUCK WASH WAXIE 2060110	337	12	27	EA	30	(3)	\$ (36)
5	22035690	HOSE GARDEN BLACK PVC NON-RUBBERIZED 300	1,760	35	51	EA	52	(1)	\$ (35)
6	22041103	SAFETY LIP BALM SPF30 15OZ TROPIX	1,851	2	1101	EA	1113	(12)	\$ (24)
7	22044308	PLATES,10"PLASTIC,MICROWAVABLE	321	3	102	EA	108	(6)	\$ (18)
8	22035232	PAINT ROLLER COVER 9X3/8 NAP FRZ#20129C	225	1	208	EA	225	(17)	\$ (17)
9	22015029	SEALANT RTV SILICONE CLR 10OZ 12 PER BX	673	14	48	EA	49	(1)	\$ (14)
10	22037786	SERVICE AWARD, BROCHURE	55	-	251	EA	249	2	-
11	22040232	BRUSH DECK 10" W/O HANDLE 2060301	118	3	34	EA	33	1	\$ 3
12	22037172	ENVELOPE ACCIDENT REPORT RM-361 25 PK	277	6	43	BDL	42	1	\$ 6
13	22044262	CUP MEASURING PLASTIC 1PT	42	8	5	EA	4	1	\$ 8
14	22041114	TOWLETTE ANTIVIRAL "PAWS"	1,022	8	122	BX	121	1	\$ 8
15	22041055	SAFETY MASK CPR LAERDAL PCKT MASK 820011	1,875	18	105	EA	104	1	\$ 18
16	22014930	BRASS RAVEN NOZZLE- SHERMAN & THOMPSON	946	9	102	EA	100	2	\$ 18
17	22037798	SERVICE AWARD, CHARM 15 YEAR	449	26	17	EA	16	1	\$ 26
18	22040289	DESCALER GEM WAXIE 870130 MINT	1,071	3	403	EA	382	21	\$ 63
19	22040284	SWISH DISINFECTANT LEMON WAXIE 170081	85	3	28	EA	5	23	\$ 69
20	22035133	PAINT SPRAY KRYLN INVERT-A-CAP WHT 12/CS	168	2	69	EA	28	41	\$ 82
21	22030324	E-Z REACHERS MODEL #32-S (NO SUB)	2,869	9	317	EA	305	12	\$ 108
22	22040470	TOWEL HAND CLNR SCRUB-IN-A-BUCKET 380307	2,415	10	238	EA	225	13	\$ 130
								Overstatement of Units	120 \$ 539
								Understatement of Units	(141) \$ (1,445)

**Attachment 2
Store 1 (B Street)**

PROCEDURE 3 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Inventory Value (Rounded to Nearest Dollar)	Unit Value (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units Per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory Value Overstated/ (Understated) in SAP
1	22040406	DOGGIE WASTE BAG WAXIE # 701600	\$ 4,559	\$ 44	103	CS	122	(19)	\$ (836)
2	22013136	PADLOCK MSTR 1KA 1CO26 W/O KEY 15 PER BX	3,345	12	269	EA	283	(14)	\$ (168)
3	22037089	BOOK COVER SELF-ADHESIVE 13" X 11"	16,904	167	101	EA	102	(1)	\$ (167)
4	22077740	GLOVE MAXIFLEX 34-874 MED 12 PER PACK	311	2	153	PR	132	21	\$ 42

Overstatement of Units	21	\$	42
Understatement of Units	(34)	\$	(1,171)

Attachment 2 Store 2 (Chollas)

PROCEDURE 2 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Inventory Value (Rounded to Nearest Dollar)	Unit Value (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit of Measure	Number of Units Per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory Value Overstated/ (Understated) in SAP
1	22035235	MASKING TAPE BLUE - 2 INCH	\$ 64	\$ 6	10	EA	38	\$ (28)	\$ (168)
2	22030362	SAW POLE-PRUNER RAZOR-BACK #62-932	569	41	14	EA	16	(2)	\$ (82)
3	22040995	SAFETY BANDAID 1X3 FLEX-FABRIC 100/BX	123	3	43	BX	56	(13)	\$ (39)
4	22030026	BLADE HACKSAW 12" STANLEY 15-412	239	5	51	EA	56	(5)	\$ (25)
5	22034920	BRUSH STENCIL #8 1-1/2" X 1-1/4"	33	7	5	EA	8	(3)	\$ (21)
6	22014563	FLASHLIGHT 3-CELL BLACK	1,013	14	72	EA	73	(1)	\$ (14)
7	22016207	FITTING CURB STOP 3/4" W/FLARE NUTJ1513C	1,915	8	245	EA	244	1	\$ 8
8	22016099	ELBOW STREET BRASS 90DEGREE 1/4"	49	3	18	EA	15	3	\$ 9
9	22030387	SCREWDRIVER - KLEIN #605-4 FLAT CAB TIP	42	8	5	EA	4	1	\$ 8
10	22030396	SCREWDRIVER FLAT TIP 10" STANLEY 66-160	220	10	23	EA	22	1	\$ 10
11	22036256	LUBRICANT WD-40 12OZ SPRAY NO SUB 12/CS	269	6	46	EA	44	2	\$ 12
12	22014510	BOOT SAFETY SIZE 9 STEEL TOE	97	14	7	PR	6	1	\$ 14
13	22014516	BOOT SAFETY SIZE 14 STEEL TOE	108	15	7	EA	6	1	\$ 15
14	22040351	LEMON BLAST Malorder eliminator SLB-335	17	17	1	EA	-	1	\$ 17
15	22014722	GLOVE GAUNTLET-SHORT LRG 12 PER PK	52	1	36	PR	24	12	\$ 12
16	22018749	PIPE PVC SCH40 1-1/2" X 20'	133	1	159	FT	120	39	\$ 39
17	22016416	FITTING AIR KING GAM12 1" MIP	47	2	19	EA	-	19	\$ 38
18	22013136	PADLOCK MSTR 1KA 1CO26 W/O KEY 15 PER BX	1,169	12	94	EA	90	4	\$ 48
19	22030324	E-Z REACHERS MODEL #32-S (NO SUB)	154	9	17	EA	9	8	\$ 72
20	22039840	LUMBER DOUGLAS FIR 4X4X16 STD&BTR DF S4S	766	19	40	EA	36	4	\$ 76
21	22040524	TOILET PAPER 2-PLY WAXIE 851218	11,584	36	326	EA	323	3	\$ 108
22	22032901	BALLAST 1-400W QUAD HPS ADV 71A8473001D	458	115	4	EA	3	1	\$ 115
23	22039830	LUMBER DOUGLAS FIR 2X4X16 STD&BTR DF S4S	1,644	9	192	EA	174	18	\$ 162
24	22014519	GATORADE PWDR MIX 8.5OZ 40/BX	4,974	2	3,000	PK	2,880	120	\$ 240
25	22014522	BUCKET CANVAS TAPERED-WALL KLEIN #5172PS	210	70	3	EA	-	3	\$ 210
26	22014643	CONE SLEEVE 6" REFLEXITE R6-28PM NO SUB	906	4	251	EA	188	63	\$ 252
27	22039833	LUMBER DOUGLAS FIR 2X10X16 #2 OR BETTER	903	25	36	EA	26	10	\$ 250
28	22022201	CASING GATE 8"OD 10GA-STEEL X 20'	1,502	19	80	EA	60	20	\$ 380
29	22030514	SOCKET SET 3/8"DR 22PCE PROTO #J52136	1,553	194	8	EA	6	2	\$ 388
30	22035172	PAINT, TRAFFIC LINE BLACK 250 GL TOTE,	5,883	8	750	GAL	500	250	\$ 2,000
							Overstatement of Units	587	\$ 4,483
							Understatement of Units	(52)	\$ (349)

Attachment 2 Store 2 (Chollas)

PROCEDURE 3 (INDIVIDUAL STOCK ITEM EXCEPTIONS):

	Material Number (Stock Item)	Material Description	Inventory Value (Rounded to Nearest Dollar)	Unit Value (Rounded to Nearest Dollar)	Number of Units Recorded in SAP	Inventory Unit Measure	Number of Units Per Physical Observation Count	Number of Units Overstated/ (Understated) in SAP	Inventory Value Overstated/ (Understated) in SAP
1	22025891	COVER METERBOX 1-1/2"-2" #SDW113 POLYCON	\$ 45,751	\$ 66	690	EA	720	(30)	\$ (1,980)
2	22014808	HAT STRAW SUN-PROTECTION W/SWEAT BAND &	230	12	19	EA	52	(33)	\$ (396)
3	22018884	TUBING COPPER TYPE-K SOFT 1" X 60'COIL	27,002	214	126	EA	127	(1)	\$ (214)
4	22040993	SAFETY BANDAID ASSRTD SHEER STRIP 60/BX	61	2	33	BX	8	25	\$ 50
5	22025902	COVER MANHOLE 36 #M-3 W/#M4 LOCK & FRAME	50,517	712	71	EA	64	7	\$ 4,984
Overstatement of Units								32	\$ 5,034
Understatement of Units								(64)	\$ (2,590)



THE CITY OF SAN DIEGO

M E M O R A N D U M

DATE: September 9, 2017

TO: Eduardo Luna, City Auditor

FROM: Kristina Peralta, Director, Purchasing & Contracting
via Ronald H. Villa, Deputy Chief Operating Officer, Internal Operations Branch

SUBJECT: Management Response to the Independent Accountant's Report on Applying Agreed-Upon Procedures Related to the Central Stores Physical Inventory

The purpose of this memorandum is provide Management's response to the findings in the June 20, 2017 report titled *Independent Accountant's Report on Applying Agreed-Upon Procedures Related to the Central Stores Physical Inventory*. Additionally, we provide information on our ongoing efforts to strengthen inventory controls and minimize physical inventory discrepancies in Central Stores stock.

As noted in the report, Central Stores successfully addressed all recommendations from the FY 2016 inventory audit. Specifically, the FY 2017 obsolete inventory process was completed timely and in good order. In addition, last year's audit noted areas in both stores that were disorganized and unusable stock was commingled with active stock. The auditors noted anecdotally that both stores were better organized and cleaner this year.

Consistent with the agreed-upon procedures, the auditors conducted physical inventory counts at both Central Stores locations. The counts were based on both random and judgmental samples, as described in the auditor's report. It is important to note that the extrapolated error rate and extrapolated dollar value of errors both declined from FY 2016 to FY 2017. The comparison between this year and last year is summarized below.

Fiscal Year	Percentage Difference between the Value of Sampled Items Counted and Sampled Items in Inventory [extrapolated error rate]	Estimated Difference in the Total Inventory Value Based on Sampling Error [extrapolated dollar value of errors]
2016	1.1%	\$24,055
2017	0.93 %	\$4,996

While declines in the error rate and dollar value of those errors are positive developments, there is clearly opportunity to improve the accuracy of Central Stores inventory.

For example, inventoried items in the pipe yard continued to have higher error rates, relative to other inventoried items. Following last year's audit, the Central Stores supervisory team developed, documented, and promulgated procedures to enhance inventory controls for the pipe yard. Based on the statistical results and the auditor's observations, it is clear that the procedures need to be more systematically followed and staff should receive refresher training on the procedures. To that end, the Central Stores supervisory team is working to refine the pipe yard procedure, train staff on the procedure, and have staff acknowledge understanding of the procedure.

In addition, Central Stores supervisory team is in the process of drafting other procedural guidance based on the results of the audit and subsequent debrief with the auditor's team and Purchasing & Contracting management.

We'd like to thank the independent accountant's audit team and the Office of the City Auditor for allowing us to comment on a draft of the report. The audit team was very professional, and provided a number of valuable observations that were greatly appreciated.

Sincerely,



Kristina Peralta
Director of Purchasing & Contracting

KP/mh

cc: Stacey LoMedico, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Rolando Charvel, City Comptroller