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Office of the City Auditor

Fleet Management Inventory Parts Review

Report Date: January 5, 2012

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## Office of the City Auditor

*"Promoting Accountability and Integrity in City Operations"*

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Office of the City Auditor  
Transmittal Letter



Date: January 5, 2012  
To: James K. Spore, City Manager  
Subject: Review of Fleet Management Parts Inventory

I am pleased to present the report of our review of Fleet Management' Parts Inventory Processes. The results of this review will be provided to City Council through the City's Audit Committee.

The results of our audit are provided in this report. Findings considered to be of insignificant risk have been discussed with management. We completed our fieldwork on November 1, 2011. It should be noted that while we found a number of control weaknesses that resulted in recommendations for improvement, this was not prompted by any known instances of fraud.

The Office of the City Auditor reports to City Council through the City's Audit Committee and is organizationally independent of all other City Departments. This report is intended solely for the information and use of the Audit Committee, City Council, City Manager, and appropriate management. It is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

We would like to commend personnel from the Department of Public Works Fleet Management Division for their courtesy and cooperation extended to us during the review. It should also be noted that management agreed with our findings and recommendations and have promptly implemented most of them prior to the issuance of the report.

If you have any questions about this report or any audit-related issue, I can be reached at 385-5872 or via email at [lremias@vbgov.com](mailto:lremias@vbgov.com).

Respectfully submitted,

Lyndon S. Remias, CPA, CIA  
City Auditor

c: City Council Members  
Audit Committee Members  
Dave Hansen, Deputy City Manager  
Phil Davenport, Interim Director, Public Works

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## **Purpose**

Review of Fleet Management purchase orders to ensure all purchases are for authorized work orders and/or inventory. To determine if controls are in place for the proper safeguarding of automotive parts inventory.

## **Scope and Objectives**

The objectives of our review were:

- To document the procedures and related controls over the automotive parts inventory
- To assess whether those controls are effectively designed to minimize risk of misappropriation
- To test those controls deemed to be designed effectively to assess whether they are operating as designed; for those controls deemed to not be designed effectively, to mitigate risk offer recommendations to improve controls to reduce risk to an acceptable level

The audit covered the fiscal year ending June 30, 2011 but some analysis incorporated the fiscal years of 2009 through 2011 for comparative purposes.

## **Methodology**

To accomplish our objectives, we performed the following procedures:

- Reviewed internal controls through inquiry and examination of documents and data.
- Gathered background information from the budget, website and written policy and procedures.
- Analyzed various InSITE reports for the InSITE Inventory accounts and associated Cost of Goods Sold accounts.
- Gained an understanding of the **Fleet** Work Order/Perpetual Inventory System (Fleet).
- Documented the significant procedures and controls associated with the purchasing, receiving, recording, issuing and physical counting of automotive parts.
- Performed a walkthrough of the inventory processes to include the procurement and issuing of inventory.
- Determined risk areas in the process whereby misappropriation of automobile parts would most likely occur and performed procedures to determine if misappropriation has occurred.
- Analyzed the annual inventory adjusting entries (from fiscal years 09, 10, 11) adjusting the InSITE inventory accounts to the year-end physical count.
- Made recommendations to improve the internal controls associated with automotive parts inventory.



## **Standards**

Our audit was conducted in accordance with generally accepted government auditing standards. The Office of the City Auditor reports to City Council through the Audit Committee and is organizationally independent of all City Departments. This report will be distributed to the City's Audit Committee, City Council, City Manager, and appropriate management within the City of Virginia Beach. This report will also be made available to the public.



## **Background**

The Fleet Management Division of the Department of Public Works is responsible for the management of fleet assets and fuel resources for the City of Virginia Beach. Fleet assets are comprised of any licensed /unlicensed motor vehicle or equipment and include rolling stock such as the following:

- Police Vehicles
- Fire and Rescue Apparatus
- Refuse Collection Trucks
- Beach Cleaners/Sewer Cleaners/Street Sweepers
- Construction Equipment (Dump Trucks , Bulldozers etc)
- Roadway Equipment
- Traffic Message Boards /Arrow Boards
- Bookmobile
- Lawn Equipment/Aviation Equipment/Marine Equipment/Generators/Pumps

The Fleet Division supplies full life cycle services for those assets to include:

- |             |   |
|-------------|---|
| Acquisition | • Replacement recommendations, bid specifications                               |
| Maintenance | • Scheduled Preventive Maintenance  |
| Repair      | • Unscheduled repair repairs and accident assessment and repair                 |
| Disposal    | • Decommission and disposal of surplus fleet assets through the auction process |

In performing the above maintenance and repair functions, the Fleet Division houses inventory at three different locations – the Main City Garage at Leroy Drive, the Holland Road Facility and the Landstown Facility.

The inventory, exclusive of fuel, consisted of the following amounts as of June 30, 2011:

Parts	\$343,283.74
Tires & Tubes	\$60,644.41
Oil & Grease	\$50,079.68



## Overview of the Process

The process by which vehicle parts are purchased, received, stocked, issued, physically counted and accounted for and the associated controls are quite detailed. The following is an abbreviated overview of the process.

It should be noted when considering the purchase and use of vehicle parts, many parts purchased are never *inventoried*. These items are ordered via a “*Special Order Parts Request Form*” directly by a mechanic through a storekeeper for a current, specific work order. Once the item is received it is delivered immediately to the mechanic and charged to the ongoing work order and therefore is never stocked /inventoried but charged directly to Cost of Goods Sold-Non-Stock.

## Purchasing

There are three basic ways parts are ordered/purchased:

1. For parts needed that **are not** stocked a mechanic requests the part to a storekeeper via a “Special Order Parts Request” form which requires the part to be charged to a valid work order in Fleet. If the item is covered under a pre-negotiated vendor contract (there are approximately 50 city contracts) the storekeeper orders the item through the vendor, confirming the contract price.
2. If the item is **not** under contract and for items over \$1000, the storekeeper will solicit at least three bids, noting the vendor contact and quoted price on the purchase order.
3. For items that **are** stocked/inventoried, the storekeeper will reorder stock items as quantities dip below established par levels.

## Receiving

At the Main Garage, there are seven cross trained storekeepers; anyone of them may be assigned duties on a rotating/availability basis and occupy the work station next to the entrance at Bay #41 to act as a “receiving agent” for items being delivered.

The assigned storekeeper will:

- Check item(s) for damage, agree item to packing slip/invoice for part type, quantity, price and initialing it to signify the review.
- Review the PO in Fleet and compare the PO to the packing slip/invoice for part type, quantity, and cost and verify all non-stock item(s) are charged to a work order.
- Unlock the PO in Fleet and receives the quantities, process the PO (increases the quantity on hand for stock item(s), non-stock item(s) are charged directly to the work order).



- Print the bin location bar code label(s) for stock item(s) and stock the item(s) on the shelf. The special-order, non-stock item(s) are given to the mechanic who ordered the item.

### **Issuing**

Any of seven storekeepers can work one of the two work stations for counter operations. The issuing storekeeper receives a request from a mechanic for a non-stock item and the above procedure is performed. If the item *is* in stock the storekeeper issues the item to the mechanic and charges the item in Fleet to the appropriate work order.

### **Accounting**

There are *two* accounting systems involved in the accounting for inventory.

1. *Fleet* which is the work order system that serves as the perpetual inventory accounting system. Fleet constantly values/updates the existing inventory at average cost, records the purchases of inventory (as received) and issuances of inventory as they are made.
2. *InSITE* which is the City's general ledger accounting system. InSITE is *not* a perpetual system. InSITE records purchases after final invoice approval and payment. Once a month, a summary report in Fleet is run which compiles all of the inventory issuances for the month. From this report a summary entry is made to reduce the appropriate inventory accounts in InSITE and charge cost of goods sold. At year end an adjustment is made in both Fleet and InSITE to reflect the results of the physical inventory.

### **Physical Inventory**

An annual physical inventory is performed by the storekeepers at year end as well as periodic cycle inventory counts of fast moving item(s). A year end inventory adjustment is made to adjust inventory in *InSITE* to the amount Fleet values the year end physical inventory by average cost. (An adjustment is also made in Fleet to the actual physical inventory as well.) When analyzing annual shrinkage it is important to realize that the annual adjustment in Fleet is made reflecting activity *since the last cycle count* – one would have to summarize all of the cycle count adjustment and the year end adjustment to arrive at an annual shrinkage amount.



## **Findings and Recommendations**

### **Finding 1: Need For Improved Separation of Duties in Inventory Processes**

There are a number of internal control weaknesses in the inventory process mostly due to an emphasis on operational efficiency/ease and the scheduling of available personnel as opposed to emphasizing the internal control structure. This is typical, the desire for efficiency is admirable and while a perfect internal control structure is rarely achieved we want to work with the available resources to obtain both operational efficiency and an internal control structure that reduces risk to an acceptable level.

Much of the control weaknesses center around the fact that the 7 storekeepers can and do carryout almost all of the inventory duties. They can purchase/order, receive, stock, issue, perform counts, create; open/close works orders, and creates purchase orders. They also all have access to the record keeping in Fleet (not InSITE). They are all cross-trained in each function and can, and do, rotate functions frequently as needed.

The desired inventory control structure set up would have:

1. Purchasing completely segregated from receiving.
2. Receiving should be segregated from storekeeping.
3. All record keeping (Fleet or InSITE) should be separated from employees who have custody over the asset (parts).

There is some segregation – but none is assured – depending on scheduling and daily assignments as to what tasks the cross-trained storekeepers are performing on a particular day. Many of the storekeepers have a substantial amount of seniority and thus have acquired significant amounts of leave. Without the ability to create entirely separate functions we offer the following recommendations to strengthen controls:

## **Recommendations**

- 1.1 Origination *of all* work orders should go through *Service* (centralized administrative personnel receive vehicle work requests from agencies). There will no longer be ‘P-cent work orders’ whereby a storekeeper himself *could* create a work order, open it, obtain and charge equipment to it and close out the work order with no one else involved in the process.



- 1.2 We recommend that while storekeepers should continue to be able to *open* work orders – obviously to do their job – they should no longer have the ability to *close* work orders as well. The closing of work orders in Fleet is a critical control. Normally, a mechanic *supervisor* has the responsibility to close a work order which would include the review of the appropriateness of all charges to the work order, including parts, made by the mechanic upon completion. However, storekeepers have the ability in Fleet to open, make charges to and close work orders – we recommend that only the supervisors be given the responsibility of closing work orders.
- 1.3 We found that a number of mechanics have the ability in Fleet to close work orders as described above; in addition to receiving and charging parts to them. We recommend those identified mechanics with the ability to close work orders no longer be able to do so to eliminate the ability of a mechanic to request parts, charge them to a work order and then give the final approval of the appropriateness of the charges. (A few mechanics are acting supervisors when needed but still cannot be allowed to close their own work orders. – see recommendation 1.4)
- 1.4 We recommend Fleet Management work with ComIT to change the responsibilities in Fleet so that any person that opens a work order can never be the one to close a work order (finalize and approve it). Thus mechanics that work as Acting Supervisors in the absence of their supervisor cannot close their own work orders after approving their own charges and supervisors couldn't charge and close the same work order.
- 1.5 In the receiving function *one storekeeper*, on any given day, performs all of following functions:
- Verifies the packing slips/invoices to the received goods & to the purchase order in Fleet.
  - Inspects the goods for damage, verifies quantity, part type /specification, price.
  - Initials & dates the packing slip /invoice forwards to them to storekeeper supervisor.
  - Unlocks the PO in Fleet and receives the item into Fleet (record the receipt of inventory).
  - Prints the bin location bar code label and physically stocks the item.

Thus the receiving storekeeper has *custody* of the physical asset (receiving & stocking) and *records* the asset in Fleet, and even theoretically could have ordered/purchased the asset. Along with other changes, we have identified and modified a Crystal “*Daily Receiving*



*Report*” whereby the report will list in Fleet each part and quantity received by purchase order. This report can be run and matched to the other receiving documents (invoice, packing slip) reviewed by the storeroom supervisor to gain assurance received item(s) have been recorded accurately in Fleet. We recommend the storeroom supervisor perform this comparison daily.

- 1.6 In conjunction with recommendation 1.5 the Storeroom Supervisor should also randomly verify daily the receiving documents to the received item(s) actually stocked on the shelves to verify they have been put on the shelf (not just recorded properly). This is important for the supervisor to perform, considering the consolidation of duties with the one receiving storekeeper.
- 1.7 We have worked with ComIT and Fleet Management to develop a *“Daily Purchase Order Report”* which lists each Purchase order issued that day or it can be run for a series of days. The report lists Purchase order number, who issued it (employee number), part number, description, quantity, unit cost and work order number. Because a number of people can issue purchase orders this will allow the storeroom supervisor to centrally view daily all executed purchase orders; who purchased what parts and for what work order. We recommend the storeroom supervisor review this report daily.

## **Finding 2: Storekeepers Perform Annual inventory Count *Without* Independent Verification**

Currently, the storekeepers themselves perform the annual physical inventory and the intermittent cycle counts of fast moving item(s). Again, this is the most efficient way to perform the count as the storekeepers are both familiar with the location of the item(s) and the parts themselves. However, this is a significant control weakness having the personnel performing the count being the same people that are accountable for the inventory. Years ago this risk was mitigated by the fact that the City Auditor’s Office was present during the annual inventory to observe the counting and perform sample test counts to verify the accuracy of the count. This was part of the City Auditor’s agreement to perform certain procedures for the external auditor to keep the price of the external audit down – the current contract contains no such provision. The external auditor *could* at any time choose to observe and sample count Fleet Management inventory in performing the CAFR audit but has rarely chosen to do so for materiality reasons. It should be noted that Fleet Management has welcomed, even invited their auditors to observe and test count the annual physical inventory.



### **Recommendation**

- 2.1 The Office of the City Auditor will annually return to observing and test counting the annual physical inventory at year end.

### **Finding 3: Periodic Physical Counts of Fast Moving items Need Proper Documentation and Recording in InSITE**

Cycle counts are periodically performed, mainly of fast moving item(s). We found that while the results of these counts were being corrected in Fleet, the adjustments were not being made in InSITE and documentation of the results were not being maintained. This makes InSITE less accurate at any given time than it could be and makes the *annual* shrinkage analysis from the annual inventory more difficult to compute. This is because the differences in the physical inventory counted at year end and what is recorded is only reflective of the time from the *last* cycle count prior to year end.

### **Recommendation**

- 3.1 We had ComIT work with Fleet Management to develop a report that would list and identify all inventory adjustments in Fleet, including those resulting from the cycle counts. We also recommend maintaining the results and documentation of those periodic cycle counts. This way we will have reliable documentation for what true annual inventory shrinkage is.

### **Safeguarding of assets**

### **Finding 4: Access to the Parts Inventory Needs to be Restricted**

We toured/visited each of the inventory locations during the daytime – the Main Garage at Leroy Drive, the Holland Road facility and the facility at Landstown Road. It became apparent that the safeguarding of the inventory could be improved. There were multiple access routes to most of the areas where the inventory was stocked at the various locations and at times it appeared that access could be gained quite easily at those accesses without being noticed or challenged. We also found that when considering nighttime hours there were many keys to the facility that have been distributed to a large number of employees.



## **Recommendations**

- 4.1 We recommend the installation of cameras at appropriate locations (interior and exterior) at the Main Garage, Holland Road and Landstown facilities. We have found this to be an effective deterrent and detective control at other facilities in the City. With these two facilities operating at a reduced capacity to deal with emergencies throughout the night, cameras would be particularly valuable. Management was receptive and indicated they could fund this recommendation.
- 4.2 We recommend strict control access over any control points to the inventory at all times at the locations. We recommend accomplishing this by the use of swipe card access and a buzzer alert. A mechanic or anyone other than a storekeeper should never be in the stock area without being accompanied by a storekeeper. Until this is implemented, we recommend reviewing who currently has key access to the parts storeroom and limiting key-holders to those that are absolutely necessary.

## **Finding 5: Modifying Issuance Report Provides Improved Control Over Special Ordered Parts**

We found from reviewing Fleet reports that the *Fleet Issuance Report* could be modified to make available a very effective control in assuring that all special parts ordered and received were in fact billed to a work order as required, not misappropriated. Remember all “special parts” ordered are never inventoried they are charged directly to a work order and charged in InSITE to Cost of Goods Sold accounts. A supervisor closing the work order verifies the part was needed and used on the work order.

## **Recommendation**

- 5.1 We recommend that storekeeper supervisor utilize this modified issuance report (modified to show all parts issued/charged to a work order by PO and WO) and compare it the daily receipt report to verify that all special order parts *received* were in fact billed and charged to a work order.



## **Finding 6: More Specific Account Coding Can Improve Controls/Monitoring**

Some specialized areas of Fleet Management order and utilize parts that are unique to those areas such as boats, the helicopter, and the Landstown location. Coding Purchase Orders and related invoices to identify with those areas would help control and monitor parts that are ordered by personnel working in those areas. For example, knowing a purchase order originated from the helicopter section would mean that purchase order should contain only helicopter parts.

### **Recommendation**

6.1 We recommend that purchase orders/invoices associated with a specific area such as the boats, helicopter etc. be coded (P-boat, P-Heli) to identify that specific area- some of that is already occurring. This would help significantly in monitoring and identifying any unusual, out of the ordinary purchases for those locations.

## **Finding 7: Additional Procedures Performed**

As a result of the need for improved segregation of duties and controls within the Fleet Management parts processes (as noted in Finding #1) we have added a number of controls in the above recommendations. Additionally, we worked with ComIT and downloaded all of the Fleet work orders for the fiscal years 09/10 and 10/11 for a total of 56,069 work orders. Of those 56,069 work orders, approximately 10% (5,442) were opened and closed by the same employee. Remember “closing” a work order is the final approval of the charges present on the work order. We identified the various employees which both opened and closed work orders (at the time they were permitted to do so) and found:

- 33 employees had the ability in Fleet to both open and close work orders and had done so in fiscal years 2010 and 2011.
- We reviewed those 33 employees with management and had their access in Fleet adjusted appropriately (mostly restricted closing of work orders to *only* supervisors).
- Of those 33, we identified two employees with a business license in the City of Virginia Beach in a parts related business and one with second employment in a parts related business. We did not note any fraudulent activity from reviewing parts on random work orders.



## **Recommendation**

7.1 Though we did not note any fraudulent activity, we recommend management continue to monitor closely any employees with parts related employment.

## **Conclusion**

Based on our review, the processes and controls governing the purchasing, accounting, issuing, physical counting, and safeguarding of vehicles parts in the Fleet Management Division of Public Works were designed with an emphasis on operational efficiency. The processes were not designed with internal controls and reduction of risk in mind and therefore contain significant control weaknesses in their design. As such, within Fleet Management available resources and with operational and cost benefit in mind, we have offered recommendations to improve the internal controls over vehicle parts. Fleet Management has worked diligently to implement the control recommendations in a timely manner, and in fact have implemented the majority of the recommendation prior to the issuance of this report.

## **Acknowledgements**

We would like to thank the personnel from the Fleet Management Division of Public Works for their cooperation and responsiveness to our requests during the review and their receptiveness to questions, recommendations and suggestions.

# Attachment A



## City of Virginia Beach

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### INTER-OFFICE MEMORANDUM

**DATE:** December 28, 2011

**TO:** Lyndon Remias, City Auditor  
Chris Ford, Deputy City Auditor

**VIA:** Phillip A. Davenport, Interim Director, Department of Public Works *PAD*

**FROM:** Reginald J. Padgett, Fleet Management Administrator

**SUBJECT:** Fleet Management Response to the Fleet Management Inventory Parts Review

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This is in response to your Fleet Management Inventory Parts Review draft report dated December 7, 2011. I would like to commend you, Lyndon & Chris, for your professional handling of this review process. Furthermore, thank you for your completion of this review & draft submission in a timely manner. The progressive review feedback was important because we were able to implement the recommendations even before the report is finally completed. Most of the recommendations have been implemented as early as our first review meeting on October 25, 2011, while a few are still in progress, depending on the software update by ComIT and the infrastructure set-up (cameras and automated entry system) being completed by vendors.

- 1. Need for Improved Separation of Duties in Inventory Processes**
  - 1.1 Public Works concurs with the audit findings. Implemented on October 25, 2011.
  - 1.2 Public Works concurs with the audit findings. Implemented on October 25, 2011.
  - 1.3 Public Works concurs with the audit findings. Implemented on October 25, 2011.
  - 1.4 Public Works concurs with the audit findings. This is being worked on.

Staff members are aware that if they open a work order, they are not authorized to close that same work order (WO). AssetWorks FleetFocus software cannot automatically prevent a person opening a WO from closing it but possibly this could happen in the future. However, with the utilization of user groups, a majority of the mechanic staff is only authorized to “finish” a WO and is unable to “close” any work order.

- 1.5 Public Works concurs with the audit findings. Implemented on October 26, 2011.
- 1.6 Public Works concurs with the audit findings. Implemented on October 26, 2011.
- 1.7 Public Works concurs with the audit findings. Implemented on October 26, 2011.

## **2. Storekeeper Perform Annual Inventory Count Without Independent Verification**

- 2.1 Public Works concurs with the audit findings. Fleet Management looks forward to having the internal and/or external auditors observe and test count the annual physical inventory at year end.

## **3. Periodic Physical Counts of Fast Moving Items Need Proper Documentation and Recording in InSITE**

- 3.1 Public Works concurs with the audit findings. Fleet Management has the reports capturing the cycle counts adjustments from October 2011. The first quarterly adjusting journal entry to record the cycle count adjustment in FleetFocus will be done in InSITE after December 31, 2011.

## **4. Access to the Parts Inventory Needs to be Restricted**

- 4.1 Public Works concurs with the audit findings. Fleet Management started the installation at the Leroy Road Parts Room on December 12, 2011 and cameras are now hooked up and awaiting final connection and testing. Camera installation at Holland & Landstown Parts Rooms are scheduled to be installed within the next forty-five (45) days.
- 4.2 Public Works concurs with the audit findings. Effective October 25, 2011, there are nine employees who have keys to the Leroy Road Parts Room. The swipe card access system should be installed within sixty days.

## **5. Modifying Issuance Report Provides Improved Control Over Special Ordered Parts**

- 5.1 Public Works concurs with the audit findings. Implemented as of October 25, 2011.

## **6. More Specific Account Coding Can Improve Controls/Monitoring**

- 6.1 Public Works concurs with the audit findings. Implemented on December 28, 2011.

## **7. Additional Procedures Performed**

- 7.1 Public Works concurs with the audit findings. Fleet Management has been monitoring any second employment or parts related business of its employees

even before this review was conducted.

The Fleet Management Division of the Department of Public Works appreciates your looking into our parts inventory processes, the review thereof, and the recommendations that you have made. We will give you an update on any pending recommendation implementation.

Please advise me if you have questions regarding our response.

RJP/amt

c: Dave Hansen, Deputy City Manager  
Phillip A. Davenport, Interim Director, Public Works  
James W. Yost, Operations Coordinator  
William F. Brooks, Storekeeper Supervisor  
Barbara G. Hall, Administrative Specialist I  
Astrophel M. Tejada, Accountant III