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INTERNAL AUDIT DEPARTMENT

Audit of Internal Controls for the
Annual Physical Inventory

Fiscal Year 2015

Issued: November 2015

Performance Audit

Project P1505

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EXECUTIVE SUMMARY

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2015 annual physical inventory (Inventory). The Inventory is coordinated by the Purchasing and Materials Management Department. Its purpose is to ensure that the on-hand quantity for each inventory item is accurately recorded in the PeopleSoft financial system so that transit operations are supported by having materials and supplies available when needed. For the fiscal year, material and supply expenditures were approximately $18.6 million or 5.1% of total expenses of $364 million.

OBJECTIVES, SCOPE AND METHODOLOGY

The audit objectives were to determine the adequacy of internal controls for the Inventory and to determine if items were accurately counted, variances and adjustments were recorded correctly in PeopleSoft and the cut-off process was followed for requisitions and receivers issued before and after Inventory. The scope of the audit was the FY 2015 Inventory.

We observed the employees as they counted the inventory items, and we independently tested a sample of the inventory counts, the cut-off process and assisted in resolving variances.

STATEMENT OF OPINION

In our opinion, in general, the FY 2015 Inventory was conducted in a manner that provides reasonable assurance that inventory items were accurately counted, adjustments to on-hand quantities were recorded correctly in PeopleSoft, the cut-off process was followed for requisitions and receivers issued before and after Inventory and significant variances were resolved and recorded correctly in PeopleSoft. We made recommendations to improve internal controls and business processes going forward as summarized below.

STRENGTHS NOTED DURING THE AUDIT

1) At the Manchester inventory location, lime green overflow stock notices were effectively used and typically placed for items with overflow stock at both the default bin location and the excess inventory location and were helpful in identifying items with overflow stock.

2) We noted improvement in the organization of items in Section 2 on the first floor of the Manchester storeroom. Items in this section were much easier to count during this Inventory because the items had been rearranged.

RESULTS OF TEST COUNTS

Based on our statistically valid sample and a margin of error of plus or minus 5%, we are 95% confident that the true accuracy rate of item counts in the population is between 86.1% and 96.1%.

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1 – INACTIVE ITEMS INCLUDED IN THE INVENTORY

At the time of Inventory, we observed that 359 out of 384 inactive stock items (383 items at the Manchester location and 1 item at the South Hills Junction location) with an average unit cost of at least $2.00 appeared on the inventory count sheets and were counted during the time of Inventory. Management stated that inactive items should not be included in Inventory and stock items should either be active because they still have a potential use at Port Authority or inactive because they have been scrapped. Inventory adjustments were timely processed when necessary for the inactive items that appeared on the count sheets.

Business Impact

If inactive items that are obsolete remain in Inventory, adequate space may not be available to store new and existing inventory items and additional time may be required to complete the Inventory as the result of counting items that no longer have use at Port Authority.

RECOMMENDATION 1

In order to possibly free up space in the storeroom for new and existing inventory items and ensure that items that should be scrapped are properly resolved, management should identify all inactive items that are currently included in Inventory. These items should be reviewed and should either be activated and maintained in Inventory, if they can still be used as part of Port Authority business operations, or they should be removed from Inventory and taken through the entire scrap process.

In addition, personnel with the ability to inactivate inventory items should be identified and should be sent a reminder to coordinate/notify the manager of purchasing materials and/or his designate before inactivating inventory items.

MANAGEMENT RESPONSE 1

Management confirmed the currently used scrap process. The manager of purchasing materials has run a query and has identified all inactive items currently in Inventory and has reviewed all items that are inactive at warehouse and locations and has determined which items should be made active again and which items should be scrapped. In addition, the manager of purchasing materials has sent a list to the manager of inventory operations and distribution of

items that can be scrapped and put into the None bin. Items that are still used on existing fleets have been made active.

Personnel with the ability to inactivate inventory items have been identified. A reminder has been sent to storeroom personnel and buyers, who currently have this ability, to coordinate/notify the manager of purchasing materials and/or his designee before inactivating inventory items.

Target Date: Implemented.

Target Date: Target date for taking items determined to be inactive through the entire scrap process (including the physical removal of scrap items and bin tags) is December 31, 2015.

OBSERVATION 2 – INVENTORY CUT-OFF PRACTICES REQUIRE IMPROVEMENT (THIS WAS AN OBSERVATION IN THE FY2014 REPORT)

At the Manchester inventory location, 27 items were received at the dock and physically placed on the shelves at their designated bin locations before Inventory without being received in PeopleSoft until Monday, February 23, 2015 (after Inventory) or put-away in PeopleSoft until Tuesday, February 24, 2015 (after Inventory). Of these 27 items, we noted the following:

1) 20 items, with an estimated dollar value of $15,949, were included as part of the initial inventory count.

2) The remaining 7 items were not counted by the counters because 6 of these 7 items were new items (1A Items) that had not yet been assigned a bin location in PeopleSoft at the time of inventory but were manually assigned a location before Inventory and physically placed on the shelf. For the remaining item, the quantity received was clearly marked with red signs that stated "Do Not Count".

3) This issue (related to the 27 items) was discussed with Purchasing and Materials Management Department personnel during the Inventory and the items were counted and were properly accounted for (prior to processing any necessary final inventory adjustments).

Business Impact

Failure to follow inventory cut-off instructions increases the risk that the value of Inventory can be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 2

Each item received after cut-off should be clearly tagged "Do not receive in PeopleSoft and/or place on the shelf until Monday after Inventory" to help ensure that the cut-off instructions are properly followed.

MANAGEMENT RESPONSE 2

Items received after cut-off will have a tag that is clearly marked with instructions to hold at the dock until inventory completion.

Target Date: January/February 2016 timeframe in preparation for the FY 2016 Inventory

Additional recommendations to improve business processes were made and they are summarized in the full report.

FOLLOW UP ON OUTSTANDING RECOMMENDATIONS FROM PREVIOUS AUDITS

We made several observations/recommendations during previous audits and only one observation/recommendation remains open. The current status of management's progress in implementing the recommended change is summarized below.

Observations/Recommendations 3 from the FY 2013 Audit, 4 from the FY 2012 Audit and 6 from the FY 2010 Audit – Multiple Items in a Bin Location

We noted several instances where more than one inventory item was assigned to the same bin location at the Manchester storeroom. This increases the possibility of incorrectly counting the quantities of the inventory items sharing the same inventory location. As a result of these conditions, additional time was needed to locate the items during the physical inventory count.

We recommended that only one item should be assigned to each bin location.

Current Status: Open – Management stated that all new items added to Inventory moving forward are being assigned to their own bin location and that they are in the process of re-assigning the approximately 3,000 items that have more than one item at a specific location and they hope to have it completed by the FY 2017 Inventory.

All other recommendations from prior audits are considered to be closed.

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2015 annual physical inventory (Inventory). The Inventory is coordinated by the Purchasing and Materials Management Department. Its purpose is to ensure that the on-hand quantity for each inventory item is accurately recorded in the PeopleSoft financial system so that transit operations are supported by having materials and supplies available when needed. This Inventory was performed from February 20, 2015 through February 22, 2015. For the fiscal year, material and supply expenditures were approximately $18.6 million or 5.1% of total expenses of $364 million.

OBJECTIVES, SCOPE AND METHODOLOGY

The audit objectives were to determine the adequacy of internal controls for the Inventory and to determine if:

- Items were accurately counted,

- Dollar variances of at least $250.00 ($150.00 at the garage inventory locations and $50.00 at the Auto Shop) and a quantity variance of at least 10 percent (5 percent at the Auto Shop) were resolved and recorded correctly in PeopleSoft,

- Adjustments to on-hand quantities were properly recorded in PeopleSoft, and

- The cut-off process was followed for requisitions and receivers issued before and after Inventory. The cut-off is the time at which system processing of receivers and requisitions is suspended in PeopleSoft. The purpose of the cut-off testing is to determine if:

  o Items that were physically received and placed in stock prior to the start of counting were included in PeopleSoft's on-hand quantities,

  o Items that were physically received and not placed in stock prior to the start of counting were not included in PeopleSoft's on-hand quantities,

  o Requisitions that were filled and shipped prior to the start of counting were processed in PeopleSoft so that the on-hand quantities in the system are reduced prior to counting,

  o Items removed from stock after counting has begun (emergency requisitions) are added to the physical count if the item was removed from stock before it was counted,

  o Items physically received while the Inventory is in progress are held at the receiving dock instead of being placed in Inventory, and

o   Employees do not resume filling requisitions, stocking items and processing requisitions and receivers in PeopleSoft until after the Inventory is finalized and the cut-off is ended.

The scope of this audit was the FY 2015 Inventory.

We conducted this performance audit in accordance with generally accepted government auditing standards except for Internal Audit's role in resolving variances in on-hand quantities at the Manchester, South Hills Village, South Hills Junction and the Auto Shop locations. 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.

We observed the employees as they counted the inventory items and we tested inventory counts and the cut-off process at the Manchester, South Hills Village, South Hills Junction and the Auto Shop locations. We tested the accuracy of the inventory cut-off process by tracing a sample of requisitions and receivers to the transaction history records in PeopleSoft to ensure that they were processed in PeopleSoft at the correct time in relation to the cut-off. We also actively assisted in resolving variances. In addition, at these four locations and at the Ross and West Mifflin operating locations, we tested the accuracy of on-hand quantities recorded by the employees conducting the Inventory by independently counting a sample of inventory items and comparing our counts with the counts on the count sheets.

STATEMENT OF OPINION

In our opinion, in general, the FY 2015 Inventory was conducted in a manner that provides reasonable assurance that inventory items were accurately counted, adjustments to on-hand quantities were recorded correctly in PeopleSoft, the cut-off process was followed for requisitions and receivers issued before and after Inventory and significant variances were resolved and recorded correctly in PeopleSoft. We made recommendations to improve internal controls and business processes going forward as summarized below.

STRENGTHS NOTED DURING THE AUDIT

1) At the Manchester inventory location, lime green overflow stock notices were effectively used and typically placed for items with overflow stock at both the default bin location and the excess inventory location. These notices referenced the item number, default bin location and the location of the overflow stock and were helpful in identifying items with overflow stock.

2) We noted improvement in the organization of items in Section 2 on the first floor of the Manchester storeroom as compared to the FY 2014 Inventory. Items in this section

were much easier to count during this Inventory because the items had been rearranged.

RESULTS OF TEST COUNTS

Based on our statistically valid sample and a margin of error of plus or minus 5%, we are 95% confident that the true accuracy rate of item counts in the population is between 86.1% and 96.1%.

Using variable sampling for a population size of 13,000 items, a statistically valid sample of 380 items was selected for testing from a population of 12,704 items with an average cost of at least $2.00. Internal Audit personnel counted each item in the sample and compared our count to the count recorded on the count sheets. Any discrepancies were resolved. We noted 34 errors (an overall accuracy rate of 91%). In addition to the systematically selected test counts from our sample, 382 judgmentally selected test counts were performed by Internal Audit personnel during the Inventory. Of these 382 counts, 351 counts were determined to be correct and 31 counts were incorrect (an overall accuracy rate of 92%). The tables below summarize the results of the testing.

Summary of Systematically Selected Test Counts

Location	Number of Items with a Unit Price of at Least $2.00	Number of Test Counts	Number of Count Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	8,940	267	24	243	91%
South Hills Village	1,987	60	5	55	92%
South Hills Junction	1,732	52	5	47	90%
Auto Shop	45	1	0	1	100%
Totals	12,704	380	34	346	91%

Of these 380 test counts, 348 items had a unit of measure of "each" and 32 items had a unit of measure of something other than "each" such as "case" or "set". We determined that 3 of these 32 items were incorrectly counted by the inventory count crews (an accuracy rate of 91%). For the 348 items with a unit of measure of "each", 31 were incorrectly counted (an accuracy rate of 92%).

Summary of Judgmentally Selected Test Counts

Location	Number of Test Counts	Number of Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	45	2	43	96%
South Hills Village	78	18	60	77%
South Hills Junction	52	0	52	100%
Auto Shop	Note 1			
West Mifflin	107	8	99	93%
Ross	100	3	97	97%
Totals	382	31	351	92%

Note 1: Internal Audit personnel assisted in counting the items at this location because it has a small number of items, so no judgmentally selected test counts were performed.

Of these 382 judgmental test counts, 342 items had a unit of measure of "each" and 40 items contained a unit of measure of something other than "each" such as "case" or "set". We determined that 1 of these 40 items was incorrectly counted by the inventory count crews (an accuracy rate of 98%). For the 342 items with a unit of measure of "each", 30 were incorrectly counted (an accuracy rate of 91%).

Note that the accuracy rates discussed above estimate the accuracy of the counts that are made by the inventory count crews. This accuracy rate should not be compared with the Purchasing and Materials Management Department's estimate of the accuracy rate at which the on-hand quantities of inventory items are maintained in PeopleSoft's records.[1]

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[1] Purchasing and Materials Management Department staff calculates their accuracy rate, which is reported on the Recap of Inventory Results – FY 2015 Inventory Accuracy report, for items with a unit value of at least $2.00 by dividing the number of items with no variances and the number of items with minor variances as determined by the Purchasing and Materials Management Department staff, by the total number of items with a unit value of at least $2.00. The Purchasing and Materials Management Department staff defines a minor variance for the Manchester, South Hills Village and South Hills Junction warehouses as one that is less than $250.00 in value and 10% in quantity. For the Auto Shop, a minor variance is defined as one that is less than $50.00 in value and 5% in quantity. For the garage locations, a minor variance is defined as one that is less than $150.00 in value and 10% in quantity.

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1 – DIFFERENCES IN NUMBER OF ITEMS WITH AN AVERAGE COST OF AT LEAST $2.00 ON PEOPLESOFT QUERY AND ON COUNT SHEETS

When reconciling the total number of items in the Inventory:

- The inventory count sheets identified the total items and the total items under $2 on the last page of the inventory count sheets for each location, and

- When subtracting these two categories, the net amount did not reconcile to the total quantity of items to be counted during Inventory (that were detailed on the report that was generated from PeopleSoft before Inventory) which lists the items in Inventory.

The reconciliation of the number of items at Manchester is as follows:

Total Items (as listed on the count sheets)	11,215
Total Items Under $2 (as listed on the count sheets)	(2,294)
Potential Total Items to Count	8,921
Actual Items to Count per Count Sheets	(8,846) *
Difference (Pre-Populated Zero Quantity)	75

(*) The actual number of items to be counted based on Internal Audit's calculation was 8,843. We noted that two Tag ID numbers (105932 and 106295) did not appear on the count sheets and that Item #96-4225 was included twice on the count sheets.

The difference was due to the items on the inventory count sheets that were pre-populated with zero quantity. These pre-populated zero quantity items (per the inventory count sheets) were not included in the items to be counted per the query nor were they included in the "Total Items Under $2" as detailed on the last page of the inventory count sheets for each of the locations. The total of the zero quantity items by location are as follows:

Zero Quantity Items

Location	Item Count
Manchester	75
South Hills Village	78
South Hills Junction	11
Total	164

Some of these items may have an average cost of $2.00 or more and should have been included on the count sheets. Internal Audit Department personnel provided a sample of these zero quantity items for the three above noted locations and discussed the average cost for the items with personnel in the Purchasing and Materials Management Department who reviewed the information and determined and/or stated the following:

a) Some items show a zero on-hand quantity and have no average cost due to not having a purchase history for these items.

b) Item #96-4225 was included twice on the count sheets (once with a unit of measure of each and once with a unit of measure of kit).

c) They were not able to determine why the two Tag ID numbers (105932 and 106295) did not appear on the count sheets and they would discuss this issue with personnel in the Information Technology Services Department.

We noted differences between the number of items with an average cost of at least $2.00 that were listed on the PeopleSoft query generated before the Inventory by Purchasing and Materials Management Department personnel and the number of items that appeared on the inventory count sheets. The detail listings of the differences noted were provided to personnel in the Purchasing and Materials Management Department for review and it was determined that not all items listed on the PeopleSoft query appeared on the inventory count sheets due to an out-of-date customized process in PeopleSoft. When running this out-of-date process, if there was no record of the item at the default bin location, the item was not listed on the count sheets. Personnel in the Information Technology Services and Purchasing and Materials Management departments explained that this process should only exclude scrap items whose default location is the "None" bin.

Business Impact

If items in Inventory with an average cost of at least $2.00 are not on the count sheets, there is a risk that these items may not be counted and that inventory shortages will not be identified for these items and/or that the items may not be available when needed for operations.

RECOMMENDATION 1

Purchasing and Materials Management Department personnel should:

1) Provide necessary information to Information Technology Services Department personnel to enable them to update the customized process and instructions for the special run-time environment to ensure that items that should be included in Inventory appear on the count sheets and work with staff at the locations to ensure that there is a follow through process for items that are new (1A items) or that have transferred bin locations.

2) Count any items with an average cost of $2.00 or greater that did not appear on the count sheets and process inventory adjustments if necessary.

3) For future Inventories, ensure that all items that should be counted appear on the inventory count sheets.

MANAGEMENT RESPONSE 1

1) Necessary information was provided to Information Technology Services Department personnel to enable them to update the customized process in PeopleSoft and instructions for the special run-time environment and Information Technology Services Department personnel have updated the physical inventory process steps instruction.

The manager of purchasing materials will run a report of any items showing a 1A location. Any results will be forwarded to the manager of inventory operations and distribution for review and to obtain a default bin location for these items, ensure a bin to bin transfer is processed in PeopleSoft for these items and that items have been moved to the default bin location. This will be completed prior to the FY2016 Inventory.

Target Date: Implemented.

2) Staff at the locations counted items with an average cost of $2.00 or greater that did not appear on the count sheets and inventory adjustments have been processed when necessary.

Target Date: Implemented.

3) The customized process in PeopleSoft has been revised and all items that should be counted should appear on the count sheets during the FY 2016 Inventory.

Prior to the FY 2016 Inventory, the manager of purchasing materials will run a test report at one of the garage inventory locations to help ensure that inventory items appear on the count sheets.

Target Date: Implemented.

OBSERVATION 2 – SIGNIFICANT OVERAGES NOTED AT THE MANCHESTER INVENTORY LOCATION

For the FY 2015 Inventory, the value of inventory overages at the Manchester location for items with variances of at least $250.00 and 10% in quantity was $347,141.53, as shown in the following table:

Description	Annual Physical Inventory Adjustments			
	2012	2013	2014	2015
Manchester inventory overages of least 10% in quantity and $250	$285,065.07	$263,329.50	$334,180.82	$347,141.53
Manchester inventory shortages of at least 10% in quantity and $250	233,067.38	136,111.39	114,676.29	188,641.99
Manchester inventory net adjustments for overages and shortages of at least 10% in quantity and $250	$ 51,997.69	$127,218.11	$219,504.53	$158,499.54

In FY 2014, the value of inventory overages totaled $334,180.82 and included 189 items valued at more than $167,000.00 that were not processed in accordance with cut-off instructions. This accounted for approximately half of the overages at the location.

During the FY 2015 Inventory, a portion of the overages appeared to relate to the following:

1) It was noted that for Item #90-5018 (turbocharger assembly), Return to Stock paperwork was not processed and the PeopleSoft on-hand quantity was not increased when these items were returned to Manchester. Item #90-5018 was adjusted for a quantity of 12 over at a dollar value of $22,257.07 during the FY 2015 Inventory; however, these 12 turbocharger assemblies were depleted on November 20, 2014 and charged to the Collier Garage as follows:

   a) 12 turbocharger assemblies were requested in error in November 2014 and were sent to the Collier garage,

   b) 12 O-rings (Item #98-5018) should have been requested rather than the turbocharger assemblies, and

   c) All 12 of these turbocharger assemblies were returned to the Manchester inventory location with a Stores Requisition – Return to Stock "pink form".

Business Impact

If paperwork for items returned to stock is not processed in a timely manner, there is a risk that the quantities in PeopleSoft will not agree with the inventory quantities on the shelf and, as a result, items may be purchased from vendors when there is an adequate quantity on hand.

RECOMMENDATION 2

1) Proper paperwork for items should be processed in a timely manner to ensure the quantities in PeopleSoft more accurately reflect the inventory quantities on the shelf

which should limit the number and value of inventory adjustments required at the time of Inventory.

2) If there are significant dollar variances noted on the final pass of the Physical Accounting Reconciliation Report at Manchester during the FY 2016 Inventory, Purchasing and Materials Management Department personnel should review these large dollar variances in an effort to determine the cause of the variances, note the reasons for these variances when they are ascertainable and retain this information in file for future reference.

MANAGEMENT RESPONSE 2

1) The normal business process when items are returned to Manchester is to attach a pink slip with the item (for processing) that shows the item returned and the quantity returned; however, when Item #90-5018 was returned to the Manchester storeroom, the pink slip was lost and the quantity returned to stock was not processed. The quantity in PeopleSoft for this item was adjusted to agree with the quantity on the shelf at the time of Inventory.

Target Date: Implemented.

2) Large dollar variances are reviewed as part of the inventory reconciliation process. When the reasons for these variances are able to be determined, a note is added to the inventory reconciliation report which is retained in file. In addition, a basic review of some of the larger variances on this report is performed after the Inventory is completed. Also, a process has been developed to receive repaired items at the dock and personnel in operations have been instructed to properly tag items that need added back to Inventory and to notify storeroom personnel when these items are placed in the storeroom.

Target Date: Implemented.

OBSERVATION 3 – INACTIVE ITEMS INCLUDED IN THE INVENTORY

At the time of Inventory, we observed that 359 out of 384 inactive stock items (383 items at the Manchester location and 1 item at the South Hills Junction location) with an average unit cost of at least $2.00 appeared on the inventory count sheets and were counted during the time of Inventory. Management stated that inactive items should not be included in Inventory and these stock items should either be active, because they still have a potential use at Port Authority, or inactive because they have been scrapped. Inventory adjustments were timely processed when necessary for the inactive items that appeared on the count sheets. Of the remaining 25 inactive items that did not appear on the count sheets, 5 included on-hand quantities greater than zero in PeopleSoft as of October 1, 2015. These 5 items were recounted on October 1, 2015 and were reviewed by management. The status of two of these items was changed to active because they still have a potential use at Port Authority and the remaining three items were determined to be obsolete/scrap.

Business Impact

If inactive items that are obsolete remain in Inventory, adequate space may not be available to store new and existing inventory items and additional time may be required to complete the Inventory as the result of counting items that no longer have use at Port Authority.

RECOMMENDATION 3

In order to possibly free up space in the storeroom for new and existing inventory items and ensure that items that should be scrapped are properly resolved, management should identify all inactive items that are currently included in Inventory. These items should be reviewed with appropriate personnel and should either be activated and maintained in Inventory (if they can still be used as part of Port Authority business operations) or they should be removed from Inventory and taken through the entire scrap process (if they are no longer usable at Port Authority). Management should verify that the scrap process for inactive items that have been determined to be obsolete has been carried through to completion and Internal Audit Department personnel should be notified once the scrap process for these items has been completed.

In addition, personnel with the ability to inactivate inventory items should be identified and should be sent a reminder to coordinate/notify the manager of purchasing materials and/or his designate before inactivating inventory items. These items should not be inactivated unless they are determined to be obsolete/scrap and they have been approved as scrap items by the manager of purchasing materials.

Personnel in the Purchasing and Materials Management Department describe the scrap process as follows:

1) Potential obsolete items at Manchester are reviewed by the manager of purchasing materials and the senior buyer - planner to determine if the items have potential Port Authority business use.
2) The storeroom supervisor is informed of which items should be scrapped.
3) Storeroom personnel do the following:
   a) Remove the items from the shelves (which assists in freeing up space in the storeroom for new and existing inventory items),
   b) Remove the bin tags,
   c) Properly dispose of the items,
   d) Adjust the on-hand quantities in PeopleSoft to zero,
   e) Move the inventory locations to the "none" bin in PeopleSoft, and
   f) Notify the manager of purchasing materials when this process is completed so that these items can be inactivated in PeopleSoft.
4) The item is inactivated in the system by the manager of purchasing materials.

MANAGEMENT RESPONSE 3

Management confirmed the currently used scrap process. The manager of purchasing materials has run a query and has identified all inactive items currently in Inventory and has reviewed all items that are inactive at warehouse and locations and has determined which items should be made active again and which items should be scrapped. In addition, the manager of purchasing materials has sent a list to the manager of inventory operations and distribution of items that can be scrapped and put into the None bin. Items that are still used on existing fleets have been made active.

Personnel with the ability to inactivate inventory items have been identified. A reminder has been sent to storeroom personnel and buyers, who currently have this ability, to coordinate/notify the manager of purchasing materials and/or his designee before inactivating inventory items.

Target Date: Implemented.

Target Date: Target date for taking items determined to be inactive through the entire scrap process (including the physical removal of scrap items and bin tags) is December 31, 2015.

OBSERVATION 4 – INVENTORY CUT-OFF PRACTICES REQUIRE IMPROVEMENT (THIS WAS AN OBSERVATION IN THE FY 2014 REPORT)

Of the 77 requisitions and receivers reviewed as part of the inventory cut-off testing, 73 (95%) were processed according to cut-off instructions. The four exceptions noted relate to items at the Auto Shop that were physically removed from the shelves before the Inventory but were not depleted in PeopleSoft until after the Inventory.

A summary of the inventory cut-off test results for requisitions and receivers is included in the following table.

Inventory Location	Number of Requisitions and Receivers Examined	Number Processed According to Cut-Off Instructions	Number Not Processed According to Cut-Off Instructions	Description of Exception Items
Manchester	20	20	0	No exceptions noted.
South Hills Village	20	20	0	No exceptions noted.
South Hills Junction	20	20	0	No exceptions noted.
Auto Shop	17	13	4	4 of the first 5 inventory requisitions (MSR #'s 190605, 190606, 190607 and 190614) processed after Inventory at the Auto Shop included items that were physically removed from the shelves from 12/16/14 to 2/18/15 (before inventory) but were not depleted in PeopleSoft until 3/26/15 (after Inventory).
Totals	77	73	4	

The assistant manager of inventory emailed inventory cut-off instructions on Tuesday, February 17, 2015 which included the following instructions:

> Starting Wednesday, 2-18-2015 at 3:30 pm, we will stop receiving items in PeopleSoft and any shipments to the dock at Manchester, South Hills Junction and the South Hills Village Rail Center, Wednesday evening or Thursday will be held and secured at the dock with the paperwork. It will not be staged to be putaway until after Inventory on Monday, 2-23-2015.

Manchester

At the Manchester inventory location, 27 items were received at the dock and physically placed on the shelves at their designated bin locations before Inventory without being received in PeopleSoft until Monday, February 23, 2015 (after Inventory) or put-away in PeopleSoft until Tuesday, February 24, 2015 (after Inventory). Of these 27 items, we noted the following:

1) 20 items, with an estimated dollar value of $15,949, were included as part of the initial inventory count.

2) The remaining 7 items were not counted by the counters because 6 of these 7 items were new items (1A Items) that had not yet been assigned a bin location in PeopleSoft at the time of inventory shut down. However, these items were manually assigned a location before Inventory and physically placed on the shelf. For the remaining 1 of these items, the quantity received for Item #85-0265 (Battery, Type HDD) was clearly marked with red signs that stated "Do Not Count".

3) This issue (related to the 27 items) was discussed with Purchasing and Materials Management Department personnel during the Inventory and these items were counted by both Purchasing and Materials Management Department personnel and Internal Audit

Department personnel during the Inventory and were properly accounted for (prior to processing any necessary final inventory adjustments).

Auto Shop

As noted in the table above, four requisitions at the Auto Shop included items that were physically removed from the shelves from 12/16/14 to 2/18/15 (before Inventory) but were not depleted in PeopleSoft until 3/26/15 (after Inventory). These items were recounted after Inventory and adjustments were processed when necessary to ensure that the on-hand quantity in PeopleSoft agreed with the actual quantity on the shelf.

Business Impact

Failure to follow inventory cut-off instructions increases the risk that the value of Inventory can be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 4

We recommend the following:

1) Each item received after cut-off should be clearly tagged "Do not receive in PeopleSoft and/or place on the shelf until Monday after Inventory" to help ensure that the cut-off instructions are properly followed.

2) In order to reduce the level of inventory at the Auto Shop we recommend that the remaining inventory items be removed from inventory through normal business use, return to vendor(s) for credit when possible or scrapped (if no longer usable at Port Authority). This process should be discussed with Finance personnel prior to implementing the process. Going forward, tires and batteries should be purchased on an as needed basis.

MANAGEMENT RESPONSE 4

1) Items received after cut-off will have a tag that is clearly marked with instructions to hold at the dock until inventory completion.

Target Date: January/February 2016 timeframe in preparation for the FY 2016 Inventory

2) Management concurs and personnel in the Purchasing and Materials Management Department and at the Auto Shop will discuss this process with Finance personnel and discuss securing a contract to procure needed parts on an as needed basis.

Target Date: Effective with the FY 2016 Inventory.

OBSERVATION 5 – EMERGENCY REQUISITIONS PROCESS CAN BE IMPROVED (THIS WAS AN ADVISORY COMMENT IN THE FY 2014 REPORT)

A summary of the inventory cut-off test results for emergency requisitions is included in the table below.

Inventory Location	Number of Emergency Requisitions Tested	Number Processed According to Instructions	Number Not Processed According to Instructions	Description of Exception Items
Manchester	4	1	3	The items removed from stock before the Inventory was performed were not added to the quantity counted during the initial count of these items for 3 emergency requisitions processed (2 of which the top white copy of the "Item Removed From Bin Form" was not removed from shelf and not turned into the supervisor and 1 of which the top white copy of this form was turned into the supervisor; however, the quantity shown on this form was not added to the initial quantity counted).
South Hills Village	4	4	0	No exceptions noted.
South Hills Junction	0	0	0	No exceptions noted.
Auto Shop	0	0	0	No exceptions noted.
Totals	8	5	3	

Internal Audit Department personnel noted that the process described in the 2015 Physical Count Instructions was not followed for 3 of the 8 emergency requisitions tested because the items removed from stock before Inventory were not added to the quantity counted during the initial count of these items. Purchasing and Materials Management and Internal Audit Department personnel worked together to ensure that the quantities removed were appropriately added to the quantity counted before processing the final inventory adjustments.

The 2015 Physical Count Instructions state the following:

> If when counting you come across a white, two-part form with red print in the bin, it is the "Item Removed From Bin Form". You will count the items in the bin and count the form as if it were a part also.

We also noted that for 2 of the 4 emergency requisitions tested at the Manchester Storeroom, the white copy of the "Items Removed From Bin Form" was not removed from the shelf and not turned into the supervisor with the count sheet and folder.

> The "Item Removed From Bin Form" states "Inventory Counters please return the white copy with your count sheet and leave the yellow copy in the parts bin location".

> Business Impact

> Failure to follow the process for handling emergency requisitions increases the risk that the value of Inventory can be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 5

The process used for handling emergency requisitions can be improved before and during the Inventory by assigning a designated employee on each shift to control and document emergency requisitions. An example of a form that can be used, in lieu of the "Item Removed From Bin Form", to assist in this process is included at the end of this report (See Attachment B). The information on this sample form includes the following:

1) The storeroom location,
2) The item number issued on the emergency requisition,
3) The item location,
4) The quantity removed from the shelf,
5) The date and time the item was removed from Inventory,
6) The location/department that required the item,
7) A column to show whether the item was removed from the shelf before or after the item was initially counted, and
8) The quantity to be entered before the final pass.

- During the Inventory, this form should be given to a storeroom supervisor or to designated Purchasing and Materials Management Department personnel to review before the final quantity is entered (by data entry personnel) in PeopleSoft before running the final pass of the Physical Accounting Reconciliation Report.

- Inventory count quantities should be increased by the quantity removed for all items issued before the item was initially counted and no adjustment should be made to inventory count quantities when items are removed from the shelf after the item was initially counted.

- The information on this form will provide assistance in properly depleting the items removed on emergency requisitions when the business units are re-opened after the Inventory is completed.

- In addition, a copy of the completed form should be provided to Internal Audit Department personnel working at the location on the final day of the Inventory.

MANAGEMENT RESPONSE 5

Attachment B or a form similar to this attachment will be used during the FY 2016 Inventory to track emergency requisitions issued while the system is shut down for Inventory. A copy of the completed form will be provided to Internal Audit Department personnel working at the location on the final day of Inventory.

Target Date: Effective with the FY 2016 Inventory.

OBSERVATION 6 – LABELS OF SOME ITEMS AT THE MANCHESTER STOREROOM CAN BE IMPROVED (THIS WAS AN ADVISORY COMMENT IN THE FY 2014 REPORT)

We noted that some of the item numbers painted on the first floor of the Manchester Storeroom (particularly in Sections 12 and 14) are starting to wear off and were sometimes difficult to read.

We also noted that some of the bin tags at Manchester are old or difficult to read or do not include a description of the item maintained in Inventory as shown in the table below.

Item #	Description	Location	Comments
96-4200	Kit, Gly-Tex Test for Ethlyne	2FLR-70-9-9	Bin tag is difficult to read
90-3528	Bumper, Rubber	2FLR-70-12-8	Green tape used as bin tag – no item description on tape
97-4224	Needle Cage (Hollow Shaft)	2FLR-70-23-6	Item # painted above bin - no item description noted
96-4028	Spacer, Bearing	2FLR-70-26-1	Bin tag is fading
96-4153	Washer, Thrust	2FLR-70-28-5	Bin tag is difficult to read
98-0024	Extrusion	2FLR-72-11-8	Green tape used as bin tag – no item description on tape

Business Impact

If inventory items are not clearly labeled, there is a risk that the wrong item may be counted and inventory adjustments may be processed incorrectly. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 6

Item numbers painted on the first floor of the Manchester Storeroom that are starting to wear off and are difficult to read should be clearly labeled. New bin tags (which provide a description of the item in addition to the item number) should be placed on the bins at Manchester for the above items and any other items when green tape is used in lieu of a bin tag or when the

information on the current bin tags is not legible. In addition, the green tape and old bin tags should be removed from the shelf at the time the new bin tags are placed on the bins.

MANAGEMENT RESPONSE 6

The manager of inventory operations and distribution and the assistant manager of inventory are in the process of obtaining all new bin tags for inventory items at Manchester. Faded item numbers on the floor at Manchester will be repainted, item bin tags that are faded or illegible will be replaced and bin location labels will be placed on bins for inventory item numbers written on green tape at Manchester. In addition, the green tape will be removed from the shelves.

Target Date: Prior to the FY 2016 Inventory.

ADVISORY COMMENT 1 – GARAGE INVENTORY – IMPROPERLY STORED ITEMS AT WEST MIFFLIN

We observed that there were many hoses lying on the upstairs floor of the West Mifflin storeroom and that bus bumper covers had been placed in front of the area where glass was stored in the body shop storage area, which could be safety hazards. Clean up and reorganization of the areas was recommended and discussed with Purchasing and Materials Management Department personnel at the time of Inventory. System Safety Department personnel were notified of this situation after Inventory and assisted with monitoring the area to ensure the parts in the areas were cleaned up and reorganized. These issues have been resolved; therefore, no further recommendation is necessary.

FOLLOW UP ON OUTSTANDING RECOMMENDATIONS FROM PREVIOUS AUDITS

We made several observations/recommendations during previous audits and only one observation/recommendation remains open. The current status of management's progress in implementing the recommended change is summarized below.

Observations/Recommendations 3 from the FY 2013 Audit, 4 from the FY 2012 Audit and 6 from the FY 2010 Audit – Multiple Items in a Bin Location

We noted several instances where more than one inventory item was assigned to the same bin location at the Manchester storeroom. This increases the possibility of incorrectly counting the quantities of the inventory items sharing the same inventory location. As a result of these conditions, additional time was needed to locate the items during the physical inventory count.

We recommended that only one item should be assigned to each bin location.

Current Status: Open – Management stated that all new items added to Inventory moving forward are being assigned to their own bin location and that they are in the process of re-

assigning the approximately 3,000 items that have more than one item at a specific location and they hope to have it completed by the FY 2017 Inventory.

All other recommendations from prior audits are considered to be closed.

ACKNOWLEDGEMENTS

Members of the Internal Audit Department thank Tony Trona, Director of Purchasing and Materials Management, Justin Cava, Manager of Purchasing Materials, Mike Musillo, Manager of Inventory Operations and Distribution, Bernie Faccenda, Assistant Manager, Inventory , Teresa Henry, Senior Buyer - Planner, Tom Kaczmarski, Stores Supervisor–FL, Tim Bell, Stores Supervisor-Rails, Jason Lamb, Stores Supervisor–Relief-FL, purchasing and storeroom personnel, inventory counters and data entry clerks for their cooperation and assistance during this audit.

Participating auditors were Sheila Dillard, Maria Nickerson, Rick Thimons and Willie Westbrook.

_____   _____
Sheila Dillard, Director, Internal Audit Department   Date

Disclaimer:

This report is intended solely for the information and use of Port Authority management for decision making purposes. It is not intended for use by any other party.

ATTACHMENT A – BUSINESS PROCESS FOR PUTAWAY AND DEPLETION

Putaway Process:

When an inventory item arrives at the receiving dock, the receiver takes possession of it and enters the receiving information into PeopleSoft which then stages the batch of items that are to be placed into the Inventory. The stockperson then places the items into the correct bin in Inventory. At the Manchester and South Hills Junction locations, the storeroom supervisor runs a process called "Complete Putaway" which increases the on-hand quantities for all items that are in the staged batch status. At the South Hills Junction location, the "Complete Putaway" process is done at the time of receiving the item. At the South Hills Village location, the "Complete Putaway" process is run automatically as part of the receiving process.

Depletion Process:

When an item needs to be removed from Inventory, the employee who needs it initiates the process by submitting a material stock request online in PeopleSoft. PeopleSoft includes this item on its pick list which is generated nightly. After the item has been picked from the shelf, the supervisor provides feedback to PeopleSoft to notify the system that the item is no longer in Inventory. At South Hills Village, a batch process runs every half hour to look for new material stock requests and a Pick Sheet prints at the stockman's printer. The stockman then fulfills the order and closes the order in the system by performing the "Material Picking Feedback" process, which confirms, ships and depletes the items that have been fulfilled. At all locations except the Auto Shop, the depletion process is run nightly to automatically reduce on-hand quantities for which feedback has been entered into PeopleSoft. At the Auto Shop, the depletion process must be run manually.

ATTACHMENT B – SAMPLE EMERGENCY REQUISITION FORM

LISTING OF ITEMS REMOVED FROM BIN DURING INVENTORY SHUT DOWN (EMERGENCY REQUISITIONS)

STOREROOM LOCATION_____

Item Number	Item Location	Quantity Removed	Date Removed	Time Removed	Location / Dept. That Required Item	Circle If Item was Removed Before Count (BC) or After Count (AC)		Quantity that Should be Entered Before Final Pass
	___/___/___/___					BC	AC	
	___/___/___/___					BC	AC	
	___/___/___/___					BC	AC	

Instructions:

1) Record storeroom name on the top of this form and record all items issued during the time period the system is shut down during the Inventory.

2) In the last column, circle "BC" if the item was removed before it was initially counted or circle "AC" if the item was removed after it was initially counted.

3) This form should be given to a storeroom supervisor or the designated Purchasing and Materials Management Department personnel to review before the final quantity is entered by data entry personnel before running the final pass of the Physical Accounting Reconciliation Report. (Inventory count quantities should be increased by the quantity removed for all items issued before the item was initially counted and no adjustment should be made to inventory count quantities when items are removed from the shelf after the item was initially counted).

4) Provide a copy of this completed listing to Internal Audit Department personnel working at the location on the final day of the Inventory.