



INTERNAL AUDIT DEPARTMENT

Audit of the Annual Physical Inventory

Fiscal Year 2016

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Performance Audit

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Audit of the FY 2016 Annual Physical Inventory

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EXECUTIVE SUMMARY

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2016 annual physical inventory (Inventory). The Inventory is coordinated by Purchasing and Materials Management Department personnel. 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 \$20.2 million or 5.3% of total expenses of \$382 million (per the unaudited financial statements as of September 6, 2016).

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 properly followed for requisitions and receivers issued before and after Inventory. The scope of the audit was the FY 2016 Inventory.

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

STATEMENT OF OPINION

In our opinion, in general, the FY 2016 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 properly 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) Cut off processes were well controlled. All 60 (100%) of the requisitions and receivers reviewed as part of the inventory cut off testing were processed according to cut off instructions.
- 2) At the Manchester inventory location, we observed improved labeling (some inventory item numbers were repainted on the floor) which assisted in properly identifying inventory items. In addition, we observed that there was a reduction in the number of items that had overflow (which are inventory items that are temporarily stored at a location that is different than the default bin location due to space limitations).

RESULTS OF TEST COUNTS

Based on our statistically valid sample and a margin of error of plus or minus 4%, we are 95% confident that the true accuracy rate of item counts in the population is between 90.4% and 98.4%.

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1 – ITEMS IN PEOPLESOFT IN MORE THAN ONE BIN LOCATION

During our review of the Manchester location, we observed 3 items in the sample (and a query generated showed 30 items) with quantities (greater than 0) in more than one bin location in PeopleSoft. There is a risk that quantities can be misstated in PeopleSoft when there is more than one bin location for an item in PeopleSoft because an incorrect inventory adjustment may be processed as a result of the quantity counted during the Inventory (at the default bin location) being added to quantity in PeopleSoft (at the non-default bin location).

RECOMMENDATION 1

A query was developed to identify inventory items with an average cost equal to or greater than \$2.00 and with quantities (greater than 0) in more than one bin location in PeopleSoft. We recommend the following:

- 1) Purchasing and Materials Management Department personnel should run this query for each business unit prior to the start of and after future annual physical inventories. This query can also be run periodically throughout the year and items identified by this query (with quantities greater than 0 in more than one bin location in PeopleSoft) that have an average cost equal to or greater than \$2.00 should be:
 - a) counted at each location shown on the query,
 - b) physically moved to their default bin location (if necessary), and
 - c) transferred to their default bin location in PeopleSoft via a bin to bin transfer (if appropriate), and inventory adjustments should be processed if necessary.
- 2) Inventory items should only have one bin location in PeopleSoft (their default bin location).

MANAGEMENT RESPONSE 1

Management concurs with item 1 and agreed to implement the recommendation during the FY 2017 Annual Physical Inventory.

Management also concurs with item 2, that inventory items should only have one bin location in PeopleSoft (their default bin location) and stated that it has been their practice to store inventory items at their default bin location.

OBSERVATION 2 – INCREASED NET OVERAGE ADJUSTMENT AT THE MANCHESTER INVENTORY LOCATION

In FY 2016, the value of Manchester's net inventory overage adjustment (total inventory overages less total inventory shortages) on the final pass of the Physical Accounting Reconciliation Report totaled \$206,699.36 (which is a 30.4% increase over the FY 2015 net inventory overage adjustment amount). This net inventory overage adjustment represents only 1% of the total material and supply expenditures of \$20.2 million (per the unaudited financial statements as of September 6, 2016).

We observed that the Stores Requisition – Return to Stock form does not state that user departments returning an item should retain a copy of the form to document or track the item that is being returned to the Manchester storeroom.

The FY 2016 overage amount was discussed with management and in an effort to determine if any inventory items on the Physical Accounting Reconciliation Report had recurring overages and/or the possible reasons for the overages, Internal Audit personnel:

1. Reviewed the inventory adjustment data for the FY 2013 through FY 2016 annual physical inventories to determine which items had consistent, larger overage adjustments processed during these annual physical inventories.
2. Discussed larger net inventory overage adjustments for FY 2013 through FY 2016 with management in the Purchasing and Material Management Department and Main Shop and noted that the net inventory overage adjustments for 26 Voith transmission parts (that are included as part of kits typically used to rebuild transmissions/engines) and an engine air brake compressor totaled \$205,705.57.

We also discussed (with management) that unused transmission/engine parts are returned to the Manchester storeroom and the process for returning the unused parts. Consequently, management reviewed the proper process for returning unused transmission/engine parts to the storeroom with supervisors at Manchester's main shop and in the storeroom to help ensure that the correct process (including paperwork) is followed going forward.

If the process for returning items to stock is not properly followed there is a risk that:

- the quantities in PeopleSoft will not agree with the inventory quantities on the shelf and additional items may be purchased from vendors when there is an adequate quantity on hand, and
- expenses may not be properly classified.

RECOMMENDATION 2

In an effort to ensure that paperwork associated with inventory items being returned to the Manchester storeroom is properly completed/processed and the on hand quantity in PeopleSoft is

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properly increased when the items are returned, we recommend that Purchasing and Materials Management Department personnel do the following:

- 1) Change the Stores Requisition – Return to Stock form to add a note to advise personnel in the user departments to make and maintain a copy of the form for their records before returning the unused part(s) and the “pink” form to the storeroom.
- 2) Send a reminder to appropriate maintenance supervisors and storeroom personnel that:
 - a) all inventory items being returned to a storeroom should be listed on a properly completed Stores Requisition – Return to Stock form.
 - b) if storeroom personnel are unable to determine the department returning the item, the item should be physically placed on the shelf, cycle counted and an inventory adjustment should be processed, if necessary, to accurately reflect the on hand quantity.
- 3) Cycle count the air brake compressor and the 26 Voith transmission parts (identified with larger dollar net overages) by September 30, 2016 and process any needed adjustments after these cycle counts are performed.

MANAGEMENT RESPONSE 2

Management concurs and stated that for items 1 and 2 above when items are returned without the proper paperwork cycle counts will be performed at the supervisor’s discretion. Items 1 and 2 in Recommendation 2 have been implemented.

Item 3 of this recommendation has been implemented as cycle counts of the air brake compressor and the 26 Voith transmission parts (identified with larger dollar net overages during this analysis) were performed in September 2016 and any needed adjustments have been processed.

FOLLOW UP ON OUTSTANDING RECOMMENDATIONS FROM PREVIOUS AUDITS

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

Observations/Recommendations 2 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.

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Current Status: Closed – Management stated that it may not be economically feasible to assign all inventory items at Manchester to their own separate bin locations. For example, additional space would be needed to store the various different sizes of sheet metal and other inventory items. Management further indicated that in order to accomplish this it may involve a significant expansion of the storeroom which is not currently planned for in the capital budget. Management will continue to analyze the bin location issue to make the best use of available space. Going forward, this issue may be addressed again in future audits.

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

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2016 annual physical inventory (Inventory). The Inventory is coordinated by Purchasing and Materials Management Department personnel. 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 5, 2016 through February 7, 2016. For the fiscal year, material and supply expenditures were approximately \$20.2 million or 5.3% of total expenses of \$382 million (per the unaudited financial statements as of September 6, 2016).

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 a quantity variance of at least 10 percent were resolved and recorded correctly in PeopleSoft,
- Adjustments to on hand quantities were properly recorded in PeopleSoft, and
- The cut off process was properly 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:
 - Items that were physically received and placed in stock prior to the start of counting were included in PeopleSoft's on hand quantities,
 - 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,
 - 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,
 - 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,
 - Items physically received while the Inventory is in progress are held at the receiving dock instead of being placed in Inventory, and

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- 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.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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 and South Hills Junction 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 assisted in resolving variances. In addition, at these three locations and at the Collier and East Liberty 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 2016 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 properly 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

Strengths noted during the audit included the following:

- 1) Cut off processes were well controlled. All 60 (100%) of the requisitions and receivers reviewed as part of the inventory cut off testing were processed according to cut off instructions.
- 2) At the Manchester inventory location, we observed improved labeling (some inventory item numbers were repainted on the floor) which assisted in properly identifying inventory items. In addition, we observed that there was a reduction in the number of items that had overflow (which are inventory items that are temporarily stored at a location that is different than the default bin location due to space limitations).

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RESULTS OF TEST COUNTS

Based on our statistically valid sample and a margin of error of plus or minus 4%, we are 95% confident that the true accuracy rate of item counts in the population is between 90.4% and 98.4%.

Using attribute sampling for a population size of 12,854 items with an average cost of at least \$2.00, a statistically valid sample of 196 items was selected for testing. Internal Audit Department personnel counted each item in the sample and compared our count to the count recorded on the count sheets. Any discrepancies were resolved by having storeroom personnel recount item count discrepancies. We noted 11 errors (an overall accuracy rate of 94%). In addition to the systematically selected test counts from our sample, 532 judgmentally selected test counts were performed by Internal Audit Department personnel during the Inventory. Of these 532 counts, 500 counts were determined to be correct and 32 counts were incorrect (an overall accuracy rate of 94%). The tables below summarize the results of the testing.

Summary of Systematically Selected Test Counts

Location	Number of Items with an Average Cost of at Least \$2.00	Number of Test Counts	Number of Count Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	9,133	140	8	132	94%
South Hills Village	1,973	30	1	29	97%
South Hills Junction	<u>1,748</u>	<u>26</u>	<u>2</u>	<u>24</u>	92%
Totals	<u>12,854</u>	<u>196</u>	<u>11</u>	<u>185</u>	94%

Of these 196 test counts, 191 items had a unit of measure of “each” and 5 items had a unit of measure of something other than “each” such as “case” or “set”. We determined that 2 of these 5 items were incorrectly counted by the inventory count crews (an accuracy rate of 60%). For the 191 items with a unit of measure of “each”, 9 were incorrectly counted (an accuracy rate of 95%).

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Summary of Judgmentally Selected Test Counts

Location	Number of Test Counts	Number of Count Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	202	16	186	92%
South Hills Village	104	8	96	92%
South Hills Junction	102	8	94	92%
East Liberty	62	0	62	100%
Collier	<u>62</u>	<u>0</u>	<u>62</u>	100%
Totals	<u><u>532</u></u>	<u><u>32</u></u>	<u><u>500</u></u>	94%

Of these 532 judgmental test counts, 502 items had a unit of measure of “each” and 30 items contained a unit of measure of something other than “each” such as “case” or “set”. We determined that 2 of these 30 items were incorrectly counted by the inventory count crews (an accuracy rate of 93%). For the 502 items with a unit of measure of “each”, 30 were incorrectly counted (an accuracy rate of 94%).

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

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1 – ITEMS IN PEOPLESOFT IN MORE THAN ONE BIN LOCATION

During our review of business unit 140CS (Manchester), we observed 3 items with quantities (greater than 0) in more than one bin location in PeopleSoft. As a result of this observation, a query was created which identified 42 items with quantities in PeopleSoft (greater than 0) in more than one bin location (30 at Manchester, 4 at South Hills Junction, 3 at Ross, 2 at East Liberty, 2 at West Mifflin and 1 at South Hills Village). These 42 items included 36 items with an

¹ Purchasing and Materials Management Department staff calculates their accuracy rate, which is reported on the Recap of Inventory Results – FY 2016 Inventory Accuracy report, for items with an average cost 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 an average cost 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 garage locations, a minor variance is defined as one that is less than \$150.00 in value and 10% in quantity.

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average cost or most recent purchase price equal to or greater than \$2.00, 3 items with an average cost or most recent purchase price less than \$2.00 and 3 items with no purchase history.

The list of inventory items identified on the query was provided to Purchasing and Materials Management Department personnel and bin to bin transfers were processed after the Inventory to ensure that quantities for the items identified on the query were listed at their default bin locations in PeopleSoft. These inventory items were recounted and inventory adjustments were processed when necessary.

Business Impact

There is a risk that quantities can be misstated in PeopleSoft when there is more than one bin location for an item in PeopleSoft because an incorrect inventory adjustment may be processed as a result of the quantity counted during the Inventory (at the default bin location) being added to quantity in PeopleSoft (at the non-default bin location).

RECOMMENDATION 1

Personnel in the Information Technology Services Department developed a query to identify inventory items with an average cost equal to or greater than \$2.00 and with quantities (greater than 0) in more than one bin location in PeopleSoft. We recommend the following:

- 1) Purchasing and Materials Management Department personnel should run this query for each business unit prior to the start of future annual physical inventories and after the completion of these inventories. This query can also be run periodically throughout the year.

For each business unit, inventory items identified by this query (with quantities greater than 0 in more than one bin location in PeopleSoft) that have an average cost equal to or greater than \$2.00 should be:

- a) counted at each location shown on the query,
 - b) physically moved to their default bin location (if necessary), and
 - c) transferred to their default bin location in PeopleSoft via a bin to bin transfer (if appropriate), and inventory adjustments should be processed if necessary.
- 2) Inventory items should only have one bin location in PeopleSoft (their default bin location).

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MANAGEMENT RESPONSE 1

- 1) Purchasing and Materials Management Department personnel will run this query (which lists quantities greater than 0 in more than one bin location in PeopleSoft) for each business unit prior to the start of future annual physical inventories, periodically throughout the year and after the completion of the annual physical inventories.

For each business unit, inventory items identified by this query (with quantities greater than 0 in more than one bin location in PeopleSoft) that have an average cost equal to or greater than \$2.00 will be:

- a) counted at each location shown on the query,
- b) physically moved to their default bin location (if necessary), and
- c) transferred to their default bin location in PeopleSoft via a bin to bin transfer (if appropriate), and inventory adjustments will be processed if necessary.

Target Date: FY2017 Annual Physical Inventory.

- 2) Management concurs that inventory items should only have one bin location in PeopleSoft (their default bin location) and it has been our practice to store inventory items at their default bin location.

Target Date: Implemented.

OBSERVATION 2 – INCREASED NET OVERAGE ADJUSTMENT AT THE MANCHESTER INVENTORY LOCATION

In FY 2016, the value of Manchester’s net inventory overage adjustment (total inventory overages less total inventory shortages) on the final pass of the Physical Accounting Reconciliation Report totaled \$206,699.36 (which is a 30.4% increase over the FY 2015 net inventory overage adjustment amount). This net inventory overage adjustment represents only 1% of the total material and supply expenditures of \$20.2 million (per the unaudited financial statements as of September 6, 2016). The net inventory overage adjustments for Manchester for the period FY 2013 through FY 2016 are shown in the table below.

Description	Manchester Annual Physical Inventory Net Overage Adjustments				
	FY 2013	FY 2014	FY 2015	FY 2016	Total
Manchester's net inventory overage adjustments (for overages and shortages of at least 10% in quantity and \$250.00)	\$127,218.11	\$219,504.53	\$158,499.54	\$206,699.36	\$711,921.54

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In FY 2014, we noted that 189 items at Manchester valued at approximately \$167,000.00 were not processed in accordance with cut off instructions which contributed to the net inventory overage adjustment. This accounted for approximately 76% of the net inventory overage adjustment for FY 2014 at the location.

In FY 2015, we noted that a net inventory overage adjustment totaling \$22,257.07 related to return to stock paperwork not being processed for Item #98-5018 (turbocharger assembly) when these items were returned to Manchester. This accounted for approximately 14% of the net inventory overage adjustment for FY 2015 at this location.

The FY 2016 overage amount was discussed with management and in an effort to determine if any inventory items on the Physical Accounting Reconciliation Report had recurring overages and/or the possible reasons for the overages, Internal Audit personnel:

- 1) analyzed all variances in excess \$5,000.00 included on the Physical Accounting Reconciliation Report in FY 2016 and noted there were 15 items on the report with inventory overages in excess of \$5,000.00 totaling \$142,389.85.
- 2) tested 20 Stores Requisition – Return to Stock forms “pink slips” at the Manchester location to determine if the inventory item quantities listed on these forms were properly processed in a timely manner in PeopleSoft for the material that was returned to Manchester. All items listed on the 20 forms reviewed were properly putaway (stock item quantities in PeopleSoft were properly increased) within 23 days of the date the material was returned to Manchester.

In addition, we observed that the Stores Requisition – Return to Stock form does not state that user departments returning an item should retain a copy of the form to document or track the item that is being returned to the Manchester storeroom.

- 3) reviewed the inventory adjustment data for the FY 2013 through FY 2016 annual physical inventories to determine which items had consistent, larger overage adjustments processed during these annual physical inventories.

A summary of the net inventory overage adjustments listed on the final pass of the Physical Accounting Reconciliation Report and issues observed during prior year inventory audits that contributed to the net inventory overage adjustments for the Manchester storeroom for FY 2013 through FY 2016 are as follows:

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Description of Net Inventory Overage Adjustments	Net Overage Amount	% of Total
FY 2014 net inventory overage adjustment related to Manchester cut off issues (identified in the FY 2014 Annual Physical Inventory report).	\$166,915.70	23.5%
FY 2015 net inventory overage adjustment related to return to stock paperwork not processed for a turbocharger assembly – Item #90-5018 (identified in the FY 2015 Annual Physical Inventory report).	22,257.07	3.1%
FY 2013 through FY 2016 net inventory overage adjustments that were greater than \$2,852.00 related to Voith transmission parts (26 inventory items that are included as part of kits typically used to rebuild transmissions/engines).	158,499.34	22.3%
FY 2013 through FY 2016 net inventory overage adjustment for an engine air brake compressor (Item #90-3200).	47,206.23	6.6%
FY 2013 through FY 2016 net inventory overage adjustment for various other Manchester inventory items.	<u>317,043.20</u>	<u>44.5%</u>
FY 2013 through FY 2016 total Manchester net inventory overage adjustment (per the final Physical Accounting Reconciliation Reports).	\$711,921.54	100.0%

As a result of the above analysis, we discussed (with management) that unused transmission/engine parts are returned to the Manchester storeroom and the process for returning the unused parts. Consequently, management reviewed the proper process for returning unused transmission/engine parts to the storeroom with supervisors at Manchester's main shop and in the storeroom to help ensure that the correct process (including paperwork) is followed going forward.

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Business Impact

If the Stores Requisition – Return to Stock forms for items returned to stock are not completed and/or submitted with the items being returned to Inventory, processed in a timely manner and/or if inventory adjustments are not processed for the items returned (when storeroom personnel are unable to determine who returned the items), there is a risk that:

- the quantities in PeopleSoft will not agree with the inventory quantities on the shelf and additional items may be purchased from vendors when there is an adequate quantity on hand, and
- expenses may not be properly classified.

RECOMMENDATION 2

In an effort to ensure that paperwork associated with inventory items being returned to the Manchester storeroom is properly completed/processed and the on hand quantity in PeopleSoft is properly increased when the items are returned, we recommend that Purchasing and Materials Management Department personnel do the following:

- 1) Change the Stores Requisition – Return to Stock form (Form No. 17-0002-A) to add a note to advise personnel in the user department to make and maintain a copy of the form for their records before returning the unused part(s) and the “pink” form to the storeroom.
- 2) Send a reminder to appropriate maintenance supervisors and storeroom personnel that:
 - a) all inventory items being returned to a storeroom should be listed on a properly completed Stores Requisition – Return to Stock form with all the requested information (the stock item number, item description, quantity returned, date returned, appropriate account to credit) and this form should contain the appropriate signatures and dates.
 - b) the copy of the Stores Requisition – Return to Stock form(s) should be retained by user departments (for a minimum of 2 years or the required records retention period, whichever is longer) to support the fact that an item(s) was returned to the storeroom.
 - c) the Stores Requisition – Return to Stock “pink” form should be returned with the unused part(s).
 - d) in the event that an inventory item with an average cost of at least \$2.00 is received without a properly completed Stores Requisition – Return to Stock form and storeroom personnel are unable to determine the department returning the item, the item should be physically placed on the shelf, cycle counted and an inventory adjustment should be processed if necessary to accurately reflect the on hand quantity.

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- 3) Cycle count the air brake compressor and the 26 Voith transmission parts (identified with larger dollar net overages during this analysis) by September 30, 2016 and process any needed adjustments after these cycle counts are performed.

MANAGEMENT RESPONSE 2

Management concurs with the audit recommendations as follows:

- 1) The Stores Requisition – Return to Stock form (Form No. 17-0002-A) has been changed to add a note to advise personnel in the user department to make and maintain a copy of the form for their records before returning the unused part(s) and the “pink” form to the storeroom.

Target Date: Implemented.

- 2) Purchasing and Materials Management Department personnel sent a reminder to appropriate maintenance supervisors and storeroom personnel related to the audit recommendation and stated that when items are returned without the proper paperwork cycle counts will be performed at the supervisor’s discretion.

Target Date: Implemented.

- 3) Cycle counts of the air brake compressor and the 26 Voith transmission parts (identified with larger dollar net overages during this analysis) were performed in September 2016 and any needed adjustments have been processed.

Target Date: Implemented.

FOLLOW UP ON OUTSTANDING RECOMMENDATIONS FROM PREVIOUS AUDITS

We made several observations/recommendations during previous audits and the current status of management’s progress in implementing the recommended changes are summarized below.

Observations/Recommendations 2 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 item was assigned to the same bin location at the Manchester storeroom. This increases the possibility of incorrectly counting the quantities of the items sharing the same inventory location. As a result of these conditions, additional time was needed to locate the items during the physical inventory.

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

Current Status: Closed – Management stated that it may not be economically feasible to assign all inventory items at Manchester to their own separate bin locations. For example, additional space would be needed to store the various different sizes of sheet metal and other

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inventory items. Management further indicated that in order to accomplish this it may involve a significant expansion of the storeroom which is not currently planned for in the capital budget. Management will continue to analyze the bin location issue to make the best use of available space. Going forward, this issue may be addressed again in future audits.

Observation/Recommendation 3 from the FY 2015 audit – Inactive Items Included in the Inventory

We noted that certain items determined to be inactive were not taken through the entire scrap process.

In order to free up space in the storeroom for new and existing inventory items and ensure that items that should be scrapped are properly resolved, we recommended that items determined to be inactive that should be scrapped should be taken through the entire scrap process (including the physical removal of the scrap items and bin tags).

Current Status: Closed - Recommendation was implemented before the start of the FY 2016 Inventory.

Observations/Recommendations 4 from the FY 2015 audit and 1 from the FY 2014 audit - Inventory Cut off Practices Require Improvement

For the FY 2015 audit, we noted that:

- a) 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.
- b) 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 putaway in PeopleSoft until Tuesday, February 24, 2015 (after Inventory).

For the FY 2014 audit, we noted that 189 items valued at approximately \$167,000.00 were not processed in accordance with cut off instructions because these items had been received, entered in PeopleSoft and placed on the shelf before the FY 2014 and FY 2011 Inventories; however, these items were not putaway in PeopleSoft until after the FY 2014 Inventory because they had not been staged for putaway.

We recommended that the remaining inventory items at the Auto Shop be removed from inventory through normal business use, returned to vendor(s) for credit when possible or scrapped (if no longer usable at Port Authority). We also recommended that 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.

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Current Status: Closed - Recommendations were implemented before the start of the FY 2016 Inventory as there were no items included in Inventory in PeopleSoft at the Auto Shop and there were no inventory items on the dock at Manchester when this Inventory began. In addition, our testing of 60 requisitions and receivers for cut off purposes during the FY 2016 Inventory included no exceptions.

Observation/Recommendation 5 from the FY 2015 audit – Emergency Requisitions Process can be Improved

We 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 and 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.

We recommended that the process used for handling emergency requisitions can be improved by assigning a designated employee on each shift to control and document emergency requisitions.

Current Status: Closed - During the FY 2016 Inventory, a form for tracking emergency requisitions was utilized and 12 of the 13 emergency requisitions tested were handled properly in relation to the cut off and the isolated exception was resolved by recounting the item after the inventory and properly adjusting the on hand quantity for this item.

Observation/Recommendation 6 from the FY 2015 audit – Labels of Some Items at the Manchester Storeroom can be Improved

We noted that some of the item numbers painted on the first floor of the Manchester Storeroom were starting to wear off and were sometimes difficult to read. We also noted that some of the bin tags at Manchester were old or difficult to read or did not include a description of the item maintained in Inventory.

We recommended that 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 and that new bin tags should be placed on the bins at Manchester for any items when green tape is used (in lieu of a bin tag) or when the information on the current bin tags is not legible.

Current Status: Closed - Faded item numbers on the first floor of the Manchester storeroom have been repainted and the item numbers that were listed on green tape have been removed from the shelves and new item labels have been placed on the applicable bins.

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

Sheila Dillard

10-6-16

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 stockperson’s printer. The stockperson 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 the depletion process is run nightly to automatically reduce on hand quantities for which feedback has been entered into PeopleSoft.