

## EXECUTIVE SUMMARY

The Office of Public Integrity (OPI) observed the annual physical inventory of the Bureau of Water on December 6, 2008. The results of the inventory indicate that the variance rate for the Water stockroom has decreased and the variance rate for the Street Lighting stockroom has increased since the last inventory observed by OPI on April 26, 2008. The variance for the Department of Recreation and Youth Services (DRYS), Bureau of Recreation inventory that is maintained by the Bureau of Water, has decreased since the last inventory on February 8, 2008. We noted the following findings during this review:

- ◆ OPI determined variances in 1.2% of our sample selection of water stockroom inventory items indicative of differences between the physical counts and the quantities recorded in the perpetual records. This is lower than the variance rate of 3.6% noted in the previous inventory.
- ◆ OPI determined variances in 6.8% of street lighting stockroom inventory items indicative of differences between the physical counts and the quantities recorded in the perpetual records. This is slightly higher than the 5.7% error rate noted in the previous inventory.
- ◆ OPI found no variances in our sample selection of the DRYS, Bureau of Recreation stockroom inventory items.

## II. BACKGROUND, OBJECTIVES, AND SCOPE

### A. Assignment

The Office of Public Integrity routinely observes and participates in annual physical inventories of various City stockrooms to independently ensure the accuracy of the inventory counts and to evaluate internal controls in the inventory maintenance process. The Bureau of Water conducted its annual physical inventory of the Water, Street Lighting, and Recreation stockrooms on December 6, 2008. OPI participated in these counts at the request of the Department of Environmental Services.

### B. Background

The Materials and Equipment unit of the Director's Office stores and manages an inventory of supplies and materials necessary to operate and maintain the water distribution system. As of December 6, 2008, the inventory consisted of 1,383 line items valued at \$1,091,661.39. In addition to the main inventory storage area on Felix Street, the Bureau of Water also

stores some inventory at the Hemlock Lake treatment facilities. Accordingly, OPI also verified the inventory at that location. As of December 6, 2008, the inventory at Hemlock Lake consisted of 76 line items valued at \$219,917.14, for a combined inventory totaling 1,459 items valued at \$1,311,578.53.

The Street Lighting unit was transferred from the Bureau of Water to the Bureau of Architecture and Engineering in 2007, however, the Materials and Equipment unit of the Bureau of Water continues to store and manage the street lighting inventory of supplies and materials. The Street Lighting unit oversees the City's street lighting system. As of December 6, 2008, the inventory consisted of 264 line items valued at \$461,041.61.

The DRYS, Bureau of Recreation stockroom was transferred to the Materials and Equipment unit of the Bureau of Water in June 2008. This inventory consisted of 1,453 line items valued at \$379,726.67 as of December 6, 2008.

Bureau of Water stockroom personnel utilize an automated inventory system that assists in controlling quantities and providing various management information. A perpetual inventory record is an essential feature of this system.

### C. Objective And Scope

The objectives of this review are to assure an accurate and complete physical inventory count and to assess the effectiveness of inventory controls.

Management is responsible for establishing and maintaining a system of internal accounting and administrative control. Fulfilling this responsibility requires estimates and judgments by management to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of accurate, informative reports that are fairly stated.

Because of inherent limitations in any system of internal accounting and administrative control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any system evaluation to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

The recommendations presented in this report include the more significant areas of potential improvement that came to our attention during the course of the examination, but do not include all possible improvements that a more extensive review might develop.

### III. RESULTS OF REVIEW

The results of this physical inventory indicate the variance rates for the Water stockroom and the Recreation stockroom have decreased since the last inventory date while the variance rate for the Street Lighting stockroom has increased slightly.

#### A. Variance Analysis - Water Stockroom

The Office of Public Integrity selected a statistical sample of items included in the stockroom inventory. The sample selection assures proper representation throughout the entire population of inventory items and allows us to accurately project the results against the entire inventory. The range of unit costs included in the sample extends from \$3,515.00 to \$0.11. OPI compared the actual count of each of these selected items to perpetual records and noted any variances.

Of the 167 inventory items tested in the sample, variances exist in two items. This represents a sample error rate of 1.2%. The following graph presents historical error rates as a reference.

Bureau of Water  
Water Stockroom Inventory  
Sample Error Rate Percentages

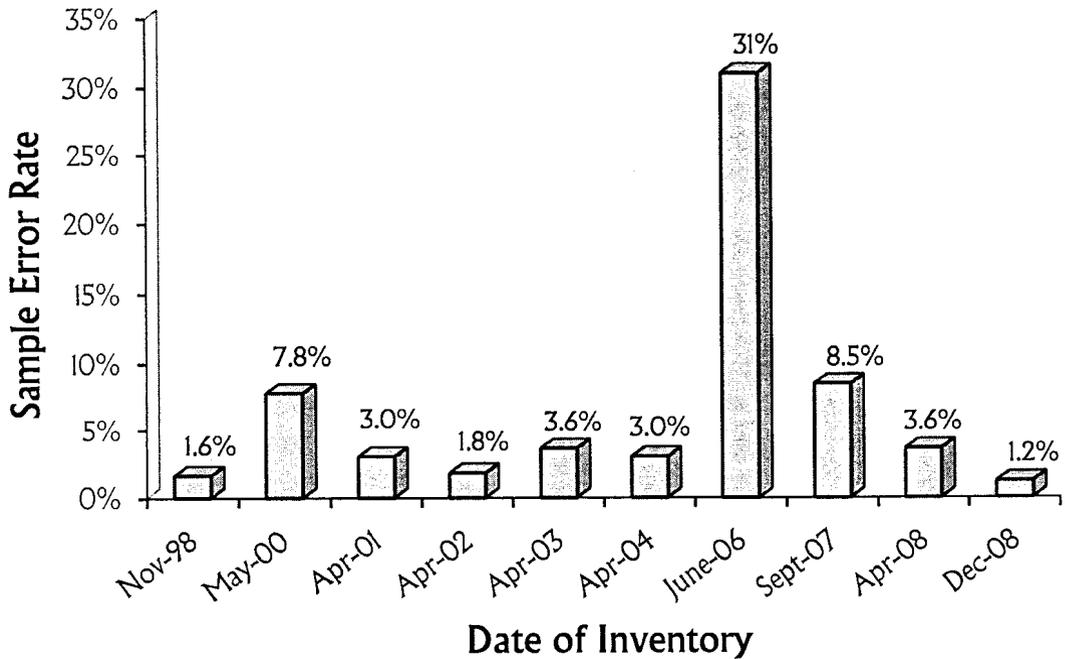


Table I (attached) presents the variance analysis of the statistical sample selection for those items in which a variance exists. It demonstrates individual variances between actual physical counts and quantities recorded in the perpetual records, and presents positive and negative variances separately. Additionally, the table includes the net variance. To eliminate counting errors, Bureau personnel recounted all items in which a difference existed between the quantities recorded in the perpetual record and the actual quantities on hand during the physical inventory.

When OPI extends the sample error rate of 1.2% to the entire population of 1,459 different stock items, the projection indicates that the actual number of errors in the population is in the range of 3 and 50 stock items. The error rate of 1.2% is lower than the prior error rate of 3.6% in the April 2008 inventory and the 8.5% in the September 2007 inventory. The positive and negative variances currently existing may indicate ineffective posting procedures to the perpetual records of the automated inventory system,

control weaknesses in computer processing, improper identification of items within inventory, or theft.

◆ Recommendation

Bureau management should continue to make inventory control a priority.

B. Variance Analysis - Street Lighting Stockroom

Due to the relatively small number of street lighting inventory line items, we examined 100% of the inventory rather than selecting a statistical sample. As a result, the error rate noted represents the true error rate in the entire population of street lighting inventory items. The range of unit costs included in the inventory extends from \$2,715.00 to \$0.01. The Office of Public Integrity compared the actual count of each of these items to perpetual records and noted any variances. Of the 264 line items in the street lighting inventory, variances exist in 18 items. The true error rate is 6.8%. Although this variance is slightly higher than the variance rate of 5.7% noted in April 2008 it is significantly lower than both the variance rate of 21% noted in September 2007 and the error rate of 20% that we noted in the 2006 inventory. The following graph presents historical error rates as a reference.

Bureau of Water  
Street Lighting Stockroom Inventory  
Inventory Variance Error Rate Percentages

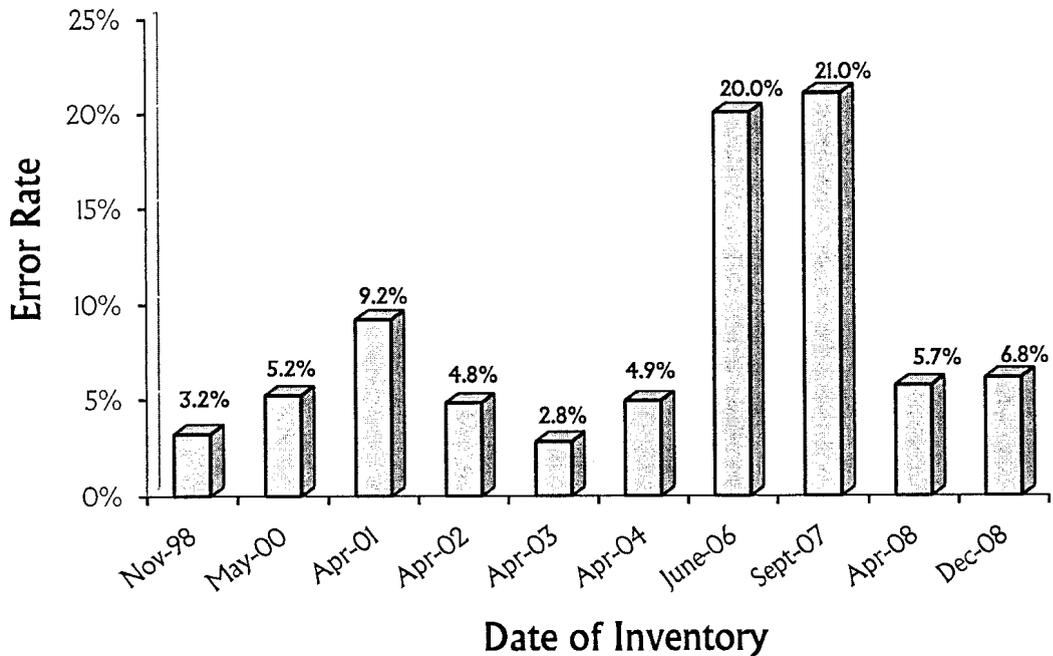


Table II (attached) presents the variance analysis for those items in which a variance exists. It demonstrates individual variances between actual physical counts and quantities recorded in the perpetual records, and presents positive and negative variances separately. Additionally, the table includes the net variance. To eliminate counting errors, Bureau of Water personnel recounted all items in which a difference existed between the quantities recorded in the perpetual record and the actual quantities on hand during the physical inventory.

When OPI compares the error rate of 6.8% to the prior error rate of 5.7% in April 2008, the variance rate has increased. The positive and negative variances that currently exist may indicate ineffective posting procedures to the perpetual records of the automated inventory system, control weaknesses in computer processing, improper identification of items within inventory, or theft. Bureau of Water personnel should establish procedures enabling them to maintain adequate control over the stockroom inventory.

## ◆ Recommendation

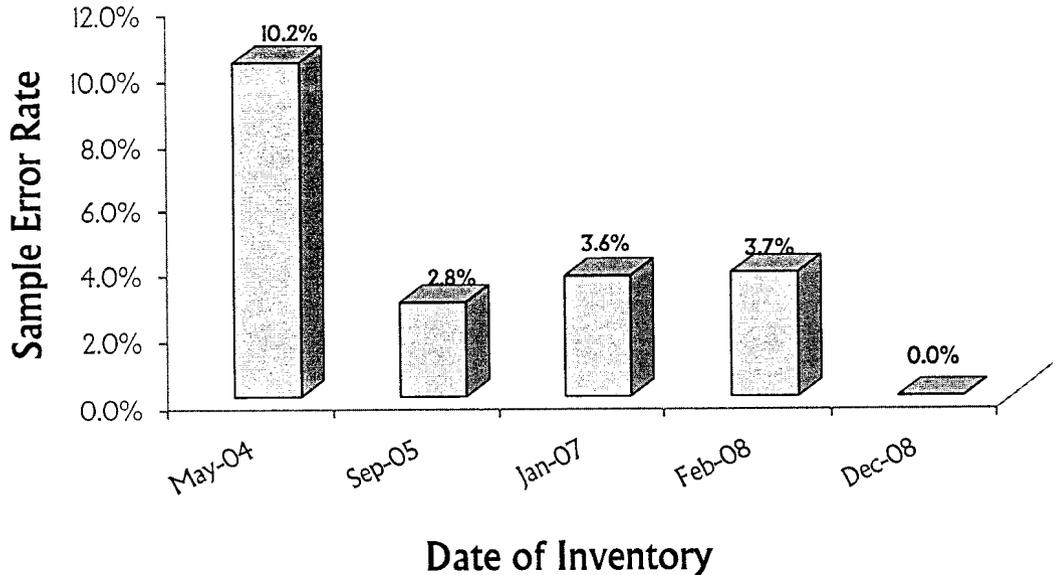
Bureau management should determine the causes of the variances, implement corrective action, and continue to make inventory control a priority.

### C. Variance Analysis – DRYS Stockroom

The Office of Public Integrity selected a statistical sample of items included in the DRYS stockroom inventory that is maintained by the Bureau of Water. The sample selection assures proper representation throughout the entire population of inventory items and allows us to accurately project the results against the entire inventory. The range of unit costs included in the sample extends from \$3,850.00 to \$.07. OPI compared the actual count of each of these selected items to perpetual records and noted any variances.

Of the 167 line items, selected variances exist in none of the items. The sample error rate is therefore 0%. This variance error rate is lower than the variance error rate of 3.7% noted in February 2008. The following graph presents historical error rates as a reference.

Bureau of Water  
DRYS Stockroom Inventory  
Inventory Variance Error Rate Percentages



To eliminate counting errors, Bureau of Water personnel recounted all items in which a difference existed between the quantities recorded in the perpetual record and the actual quantities on hand during the physical inventory.

When OPI extends the sample error rate of 0% to the entire population of 1,453 different stock items, the projection indicates that the actual number of errors in the population is in the range of 0 and 20 stock items. Bureau of Water personnel should continue to maintain control over the stockroom inventory.

◆ Recommendation

Bureau management should continue to make inventory control a priority.

IV. DEPARTMENTAL RESPONSE

The response of the Department of Environmental Services follows.



TABLE II:

Department of Environmental Services  
 Bureau of Water  
 Street Lighting Stockroom Inventory – December 6, 2008  
Schedule of Items with Variances Only

| Stock Number | Part Description                    | Quantity On Hand | Quantity Counted | Item Count Variance |            | Unit Cost | Dollar Variance   |                       |
|--------------|-------------------------------------|------------------|------------------|---------------------|------------|-----------|-------------------|-----------------------|
|              |                                     |                  |                  | Over                | Short      |           | Over              | Short                 |
| 5L325NW      | Nut & washer 1" for anchor bolts 8e | 0                | 70               | 70                  | 0          | 8.00      | \$ 560.00         | 0.00                  |
| 2L245        | Cobrahead 150W L/S used type III    | 30               | 0                | 0                   | 30         | 69.00     | 0.00              | (2,070.00)            |
| 2L247        | Cobrahead 400W used type II         | 39               | 0                | 0                   | 39         | 73.00     | 0.00              | (2,847.00)            |
| 2L325B       | Cobrahead 250H L/S black type III   | 0                | 12               | 12                  | 0          | 203.00    | 2,436.00          | 0.00                  |
| 7A73B        | Fixt. Rn 20150H                     | 10               | 3                | 0                   | 7          | 665.50    | 0.00              | (4,658.50)            |
| 7F1A1SF      | Slipfitterw/PH LMS19730C            | 29               | 7                | 0                   | 22         | 167.00    | 0.00              | (3,674.00)            |
| 7F2A1A       | Arm 6'R92D & Scroll                 | 0                | 9                | 9                   | 0          | 440.00    | 3,960.00          | 0.00                  |
| 7FIASW       | Slipfitter AT50 w/PH8               | 26               | 4                | 0                   | 22         | 204.00    | 0.00              | (4,488.00)            |
| 4LI30        | Handhole w/ plastic cover           | 2                | 1                | 0                   | 1          | 60.94     | 0.00              | (60.94)               |
| 1L899        | Refractor acorn Granville type      | 15               | 12               | 0                   | 3          | 210.00    | 0.00              | (630.00)              |
| 5G00I        | Shroud 2 pc sq. brz.h.f./qt59786    | 20               | 4                | 0                   | 16         | 140.00    | 0.00              | (2,240.00)            |
| 5LI0I        | Pole 30' galv sign. davit-used      | 1                | 0                | 0                   | 1          | 175.00    | 0.00              | (175.00)              |
| 5LO14BH      | Pole 14' w/HH, FB/blk               | 6                | 7                | 1                   | 0          | 260.00    | 260.00            | 0.00                  |
| 0LO15        | 150w noncycling hps lamp            | 26               | 24               | 0                   | 2          | 12.05     | 0.00              | (24.10)               |
| 3LO088K      | 8' Mast arm black (galv)            | 0                | 1                | 1                   | 0          | 145.40    | 145.40            | 0.00                  |
| 5LI20U       | 20' Single galv. davit – used       | 4                | 0                | 0                   | 4          | 0.00      | 0.00              | 0.00                  |
| 5LO22MS      | Shroud-modified base adapters       | 0                | 1                | 1                   | 0          | 0.00      | 0.00              | 0.00                  |
| 8LA3B        | Bandit buckles #C256-B (box)        | <u>2</u>         | <u>3</u>         | <u>1</u>            | <u>0</u>   | 62.07     | <u>62.07</u>      | <u>0.00</u>           |
|              |                                     | <u>210</u>       | <u>158</u>       | <u>95</u>           | <u>147</u> |           | <u>\$7,423.47</u> | <u>\$ (20,867.54)</u> |

Net Variance . . . . . \$ (13,444.07)



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CITY OF ROCHESTER  
OFFICE OF PUBLIC INTEGRITY



To: Daniel Markese, Internal Audit Manager/OPI  
From: Paul Holahan, Commissioner/DES   
Date: January 30, 2009  
Subject: **INVENTORY AUDIT RESULTS – WATER, ST. LIGHTING, and DRYS**

The Water Bureau conducted its physical inventories of the Water materials, St. Lighting materials, and DRYS materials stockrooms on December 6, 2008. The last physical inventory of these areas was performed April 26, 2008. The Office of Public Integrity observed these inventories.

The results of the inventories indicate that the Water Materials inventory had a decrease in the variation rate over the previous count from 3.6% to 1.2%; St. Lighting had a slight increase, from 5.7% to 6.8%; and DRYS had a 0% variation rate, down from 3.7%.

The July 2008 transfer of the DRYS warehouse operation from DRYS to Water, and the replacement of the retired Water Materials Coordinator brought two highly motivated persons to the operation. A major initiative to organize the newly-acquired DRYS materials and to reorganize the existing Water and St. Lighting materials was undertaken. As a result of those efforts, we successfully added 1,453 DRYS items, valued at \$380,000, to our existing operation. We eliminated many obsolete Water items and added a net of 81 new Water line items (including all water meters and accessories), with a net value of \$221,000, and added 18 St. Lighting items, valued at \$68,000, to our system. In total, we increased our number of parts lines by 1,567 and our recorded value by \$670,000. We now have 4,290 parts lines with a current value of \$2.15m. Virtually every item has been labeled with a machine-printed label to eliminate any confusion as to part number/description. Utilizing a plastic bag sealer, small parts are now pre-packaged in-house, with part number and package quantity information listed safely inside the package, minimizing miscounts and identification errors.

These concerted efforts have produced the desired results. Water and DRYS variance rates have declined. The small increase in the St. Lighting variance rate is attributed to clerical errors. Of the 16 recorded variances, two items were renumbered but the old number was never cleared; two items were issued as parts of sets, but their individual part numbers were not properly listed.

The staff has addressed most of the issues identified by this audit. The department will continue to make inventory control a top priority. Please contact me for further discussion or comments. Thank you.

xc: R. Morrison  
G. Giudice

