

April 4, 2005

Internal Audit Report 2005-5
2004 Parts Inventory
Municipal Light and Power

Introduction. The Operations Division at Municipal Light and Power (ML&P) operates a warehouse for parts required in their day-to-day operations. Inventory records for the parts are maintained in PeopleSoft. There are approximately 1,355 line items worth \$2,898,118.71 stored in the warehouse. The warehouse is inventoried on a perpetual basis.

Objective and Scope. The objective of this audit was to determine the accuracy of the Operations Warehouse inventory records. Specifically, we inventoried 76 randomly selected items from the Inventory Stock Master Report. The audit was conducted in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review, and accordingly, included tests of accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of December 2004 through January 2005. The audit was requested by the Administration.

Overall Evaluation. Inventory records at the Operations Warehouse were not totally accurate. Further, there was no policy and procedure for performing the perpetual inventory. In addition, we found access to the warehouse was not restricted to warehouse personnel only.

FINDINGS AND RECOMMENDATIONS

1. No Policy and Procedure Exists.

- a. Finding.** The Operations Warehouse has no written policy and procedure for performing the perpetual inventory. We found no written procedures stating who

should perform the inventory, in what time-frame, and what should be done if a discrepancy existed.

- b. **Recommendation.** Written procedures should be developed for performing a perpetual inventory of the Operations Warehouse. The procedures should include who should perform the inventory, in what time-frame, and what should be done if a discrepancy exists.
- c. **Management Comments.** Management stated, “ML&P is in agreement with Internal Audit’s finding that ML&P currently has no Policy and Procedure (P&P) for performing perpetual inventory. Furthermore, ML&P agrees with Internal Audit’s recommendation to develop a written P&P for the Operation’s Warehouse. This P&P will be completed no later than year-end 2005.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Warehouse Access Unrestricted.**

- a. **Finding.** Access to the Operations Warehouse was unrestricted. We found the door to the warehouse open, allowing anyone to enter. Also, we found that non-warehouse personnel used a table in the warehouse for breaks and lunch. By not restricting access to only warehouse personnel, parts may be removed without proper documentation.
- b. **Recommendation.** The Operations Warehouse should consider limiting access to the Operations Warehouse to essential warehouse personnel only.
- c. **Management Comments.** Management stated, “ML&P is in agreement with Internal Audit’s finding that access to the Operation’s Warehouse is unrestricted.

Unfortunately, due to space constraints, the warehouse facility is also used for a break room for the line crews as well as a meeting room for crews, foremen and superintendents. Other operational situations requiring unlimited access include 1) the swing-shift loop wagon where a two-man crew accesses the warehouse after normal working hours in order to respond to after-hours outages and trouble calls, 2) the on-call duty supervisor and called out line crews need access to the warehouse after hours on evenings, weekends and holidays for power restoration efforts.

“Since it isn’t cost effective to hire an additional warehouse person to work the swing-shift in order to maintain tighter control over inventory, ML&P has not elected to do so. Therefore, ML&P can only limit the access to the extent that they can effectively carry out the business needs of the utility. Ultimately, ML&P will look for ways to improve in this area without driving up the cost to their members.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Inventory Records Inaccurate.**

- a. **Finding.** Our test of the inventory records at the Operations Warehouse found them to be inaccurate. Our random sample of 76 of 1,355 line items found discrepancies with 11 of the 76 items we sampled, a 14% error rate. However, the dollar value of these errors amounted to only \$118.25, compared to \$194,687.58 for the 76 items sampled. The lack of policies and procedures as well as the unrestricted access to the warehouse may have contributed to these errors.
- b. **Recommendation.** Operations Warehouse personnel should ensure that inventory records are accurately maintained. In addition, ML&P should consider using an annual physical inventory count rather than the perpetual inventory method currently being utilized.

- c. **Management Comments.** Management stated, “ML&P is in agreement with Internal Audit’s finding that the random sample of 76 out of 1,355 line items showed a discrepancy with 12 of the 76 items or a 16% error rate. However, the financial discrepancy for these same line items (a \$118.25 error out of \$194,687.58 sampled) comes out to be a 0.06% error rate. Furthermore, the error rate based upon actual counts of material versus the number listed on inventory typically showed a greater percentage variance for the smaller dollar items as opposed to the larger dollar items counted in the random sample. Therefore, one can conclude that the 16% physical count error cannot be correctly applied to all warehouse inventory items.

“ML&P previously used an annual physical inventory count, but went to a perpetual inventory system when PeopleSoft was implemented. The perpetual count currently offers the advantage of maintaining tighter inventory control regarding maintaining inventory levels on hand as opposed to the annual count system which is critical to insure required materials are on hand for timely completion of construction projects. Furthermore, ML&P’s records for the last three years indicate that the perpetual counting process that is currently in use provides a greater degree of accuracy than the annual counting process that was used previously. Also, the current process represents a substantial economical benefit in that the cost of the annual physical inventory far exceeds the average dollar value of the errors found. Therefore, ML&P is electing to stay with the perpetual inventory counting system at this time.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on February 3, 2005.

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