

ASD INTERNAL AUDIT REPORT

2015-02

Student Nutrition Warehouse Inventory Controls

Anchorage School District

April 9, 2015

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Mayor Dan Sullivan

April 9, 2015

Anchorage School District Superintendent and Members of the School Board:

I am pleased to present **ASD Internal Audit Report 2015-02, Student Nutrition Warehouse Inventory Controls, Anchorage School District** for your review. A brief summary of the report is presented below.

We have completed an audit of the Anchorage School District's Student Nutrition Warehouse Inventory Controls. The objective of this audit was to determine the adequacy of internal controls for receiving, storing, issuing, and accounting of items in the Student Nutrition warehouse. To achieve our objective we interviewed Student Nutrition staff to identify internal controls and responsibilities for managing inventory. We also conducted our own inventory of selected items and reviewed inventory adjustments processed from January 1, 2014 to December 19, 2014. Additionally, we evaluated the process to discard warehouse inventory items and the reasonableness of user privileges in OneSource.

Inventory controls and procedures at the Student Nutrition warehouse need improvement. Specifically, the warehouse was not properly organized and the warehouse location field in OneSource was not used. Moreover, items were not always entered into OneSource timely, inventory records were inaccurate, discarded food items were not always accurately categorized, and expiration dates and par levels were not used to manage inventory items. Also, OneSource user access did not always appear reasonable, the warehouse lacked adequate procedures, warehouse security did not prevent unauthorized access, and personal employee goods were comingled with warehouse inventory.

There were eleven findings in connection with this audit. Management was responsive to the findings and recommendations.



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Introduction. The Student Nutrition Department (Student Nutrition) maintains a warehouse with over 275 stock items consisting of dry and frozen foods and supplies to support food production and distribution to over 80 schools. The warehouse delivers food orders to the schools and issues items to the Central Kitchen, which prepares pans of food and single serve meals such as chicken alfredo pasta and whole grain macaroni and cheese. The Central Kitchen operates adjacent to the warehouse. Student Nutrition uses the OneSource software to manage the warehouse inventory. Physical inventory counts are conducted to check on the validity of records in OneSource.

Objective and Scope. The objective of this audit was to determine the adequacy of internal controls for receiving, storing, issuing, and accounting of items in the Student Nutrition warehouse. To achieve our objective we interviewed Student Nutrition staff to identify internal controls and responsibilities for managing inventory. We also conducted our own inventory of selected items and reviewed inventory adjustments processed from January 1, 2014 to December 19, 2014. Additionally, we evaluated the process to discard warehouse inventory items and the reasonableness of user privileges in OneSource.

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 2014 through January 2015. The audit was requested by the Anchorage School District Budget and Audit Committee.

Overall Evaluation. Inventory controls and procedures at the Student Nutrition warehouse need improvement. Specifically, the warehouse was not properly organized and the warehouse location field in OneSource was not used. Moreover, items were not always entered into OneSource timely,

inventory records were inaccurate, discarded food items were not always accurately categorized, and expiration dates and par levels were not used to manage inventory items. Also, OneSource user access did not always appear reasonable, the warehouse lacked adequate procedures, warehouse security did not prevent unauthorized access, and personal employee goods were comingled with warehouse inventory.

FINDINGS AND RECOMMENDATIONS

1. Warehouse Not Properly Organized.

- a. **Finding.** The food warehouse, including the cold storage section (freezer), was not properly organized and maintained. Many storage racks were not assigned with a bin label. Food items were stored in numerous locations and in the aisles making it difficult to find items. For example, our sample inventory disclosed Rice Krispie meals located in 14 different locations throughout the warehouse. Another item, mini corn dogs, was located in eight different locations throughout the freezer.
- b. **Recommendation.** The Chief Operating Officer should reorganize the warehouse, including the freezer section, with each item placed in the same numbered bin location. Items should not be stored in aisles.
- c. **Management Comments.** Management concurred and stated, “Management agrees with the recommendation that there needs to be improvement in the organization of the warehouse, including the freezer section. We will assign all storage racks with a location. We will review the limitations and capabilities of our current software to determine the feasibility of utilizing more detailed location descriptions within the system. We will also attempt to find an inventory software program that will allow rack locations to be entered into a separate field within the inventory record for reference rather than the current generic locating system. We believe with the information we gathered from the

new school programs and procurement procedures implemented this year we will be able to more accurately order next year and have improved success in reducing the amount of products sitting in aisles not assigned to bins.”

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

2. **Warehouse Locations Not Used.**

- a. **Finding.** The warehouse location field in OneSource was not used to record where items were located. Instead, general descriptions were entered such as “Dry”, “Freezer” and “Cooler”. The reason given for not entering specific locations was that it was a cumbersome and ineffective process because inventory locations were always changing making the assignment of accurate locations impossible. Without accurate and specific warehouse locations, retrieving items from the warehouse was a hit and miss process and resulted in items stored in numerous locations. Consequently, it was difficult to ensure that the oldest product was used first.
- b. **Recommendation.** The Chief Operating Officer should ensure that accurate warehouse locations are entered in the location field in OneSource. The warehouse should be organized with standard locations for each product and clearly marked with a location identifier. New shipments should be stored in the standard location and not moved to other locations. The items should be arranged so that the oldest product can be used first to minimize loss of food items due to spoilage.
- c. **Management Comments.** Management concurred and stated, “Management agrees with the recommendation there needs to be improvement in being able to accurately locate all products within the warehouse. We will assign all storage racks with a location. We will review the limitations and capabilities of our current software to determine the feasibility of utilizing more detailed

location descriptions within the system. We will also attempt to find an inventory software program that will allow rack locations to be entered into a separate field within the inventory record for reference rather than the current generic locating system. We will also attempt to find better ways to ensure First-In First-Out (FIFO) product usage limiting the possibility of food waste.”

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

3. **Receipts of Inventory Items Not Entered in OneSource Timely.**

- a. **Finding.** Items received in the warehouse were not always entered into OneSource in a timely manner. In order to enter inventory receipts in OneSource, the shipping documents must be placed in a basket located in the warehouse office. However, since all warehouse employees were involved in receiving and verifying shipments into the warehouse, the shipping documents were not always placed in the basket, but were left in various places in the warehouse. For example, we found a shipment of green beans had been delivered in October but had not been entered in OneSource as of November 19. We also noted that some staff often threw the receipt paperwork on the foreman’s desk, without his knowledge, or left the receipts in the loading dock, instead of placing the documents in the basket.
- b. **Recommendation.** The Chief Operating Officer should ensure that procedures are strengthened for the receiving function at the warehouse. Consideration should be given to assigning receiving duties to one or two warehouse employees who could then be held accountable for receiving, inspecting and documenting the receipt of shipments into the warehouse.

- c. **Management Comments.** Management concurred and stated, “Management agrees with the recommendation of the importance of timely input of all inventory receipts. We will look at our procedures and make any necessary changes. We will ensure all receiving employees are trained on any new procedures and that the receiving documentation is entered by the assigned employee in a timely manner.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. **OneSource Inventory Records Not Accurate.**

- a. **Finding.** On-hand balances in OneSource were not accurate. Our sample inventory revealed significant differences between our physical count and OneSource records. A partial physical inventory, conducted by warehouse personnel during our audit, also identified erroneous record balances. However, this inventory did not include items in the freezer section because it was too full to inventory. The following table contains examples of some of the discrepancies identified by warehouse personnel in their partial physical inventory:

**Inventory Discrepancies
December 2014**

<u>Product</u>	<u>OneSource Record</u>	<u>Inventory Count</u>	<u>Discrepancy Over/(Short)</u>
Peaches Fruit Cup	524	383	(141)
Pears Sliced Bulk	894	732	(162)
Green Bean Bulk	1,764	1,974	210
Mix Muffin	168	241	73

Source: Warehouse Inventory Adjustment Worksheet

In addition, other OneSource inventory reports, such as the Perpetual Inventory Value Report and the Inventory Movement Report, sometimes reported negative on-hand quantities.

Perpetual Inventory Value Report

<u>Description</u>	<u>Quantity</u>	<u>Value</u>
Pizza Cheese	-172	\$ (12,339)
Cherry Tomato	-797	\$ (1,511)
Fat Free Chocolate Milk	-3,100	\$ (1,271)
Lettuce 5 Lb Bag	-158	\$ (849)
Broccoli Florette	-152	\$ (827)

Source: Perpetual Inventory Value Report

Inventory Movement Report

<u>Description</u>	<u>Starting Quantity</u>	<u>Adjusted</u>	<u>Updated Quantity</u>
Acai Berry Sparkling Juice	-3	-3	-6
Apple Juice	-49	-101	-150
Bar Banana Benefit	-27	-4	-31
Broccoli Florette	28	-81	-53
Cherry Cup	0	-89	-89
PC BBQ Sauce	-28	-44	-72

Source: Inventory Movement Report

Without accurate inventory records, it is impossible to identify what items should be ordered or which items are in excess of anticipated needs.

- b. **Recommendation.** The Chief Operating Officer should ensure OneSource inventory records are maintained accurately to reflect actual items in stock. In addition, periodic scheduled physical inventories should be performed of the entire warehouse and freezer section. Discrepancies between on-hand quantities and record balances should be researched before adjustments are made to the records.
- c. **Management Comments.** Management concurred and stated, “Management agrees our system inventory numbers are not always accurate. System errors have been discovered and the vendor fixes to those issues should be made with the next scheduled upgrade in June 2015. We perform partial or full inventories of the warehouse and freezer three times during the year (Christmas Break, Spring Break, and End of Year) in order to bring physical inventories in line with the system inventory in order to minimize any differentials.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Spoiled, Broken and Discarded Items Not Accurately Reported.**

- a. **Finding.** Spoiled, broken and discarded items were not always accurately categorized in the Inventory Movement Report. For example, we observed boxes of lettuce, yogurt, tomatoes and carrot sticks marked with signs stating “do not use” or “discard”. Our review of the Inventory Movement Report showed that some adjustments for these items had been categorized as “correct” or “other”, thus misrepresenting the actual disposition of the items. For the period January 1, 2014 through December 19, 2014, we noted that 913 (about \$2 million) of 28,994 transactions were categorized as “other”. According to staff, the category of “other” should not be used because it affects how inventory items are expensed. The Inventory Movement Report is a record of inventory transactions that shows

the flow of product quantities and values as they move in and out of the warehouse on account of receiving, shipping, and food preparation. The movement of inventory is recorded through an adjustment by staff who assigns an adjustment reason or movement type. The inventory movement report also shows spoiled and damaged product.

- b. **Recommendation.** The Chief Operating Officer should ensure that items issued or discarded from the warehouse be categorized accurately in the Inventory Movement Report. General categories such as “other” should not be used.
- c. **Management Comments.** Management concurred and stated, “Management agrees that some of the inventory transactions have been reported incorrectly. There have been software limitations which have forced certain transaction decisions to be made and the use of ‘other’ was made too often leading to little information being available. We have asked and will receive a programming change with the next system upgrade in June 2015 which will allow for more information to be input minimizing the possibility of inaccurately reporting items. The staff has also been instructed to limit their use of ‘other’ for adjustments and to input complete comments on the transactions into the system.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Food Expiration Dates Not Used.**

- a. **Finding.** Expiration dates were not used to manage the items stored in the warehouse. Since expiration dates were not entered into the OneSource inventory records, warehouse personnel would sometimes write the expiration dates on the food pallets. Consequently, the oldest items or items close to the expiration date

were not always issued first. This contributed to outdated items having to be disposed of. Accurately documenting expiration dates will help manage items stored in the warehouse and minimize spoilage and waste.

- b. **Recommendation.** To properly manage items stored in the warehouse and minimize waste, the Chief Operating Officer should actively use product expirations dates to ensure that the oldest items are used first.
- c. **Management Comments.** Management concurred and stated, "Management agrees that food expiration dates are very important to ensure food is located in a timely manner and used properly to limit waste. The warehouse writes the receipt date, best by date or expiration date on the pallets and every attempt is made to pull food by First-In First-Out (FIFO). We will review the limitations and capabilities of our current software to determine the feasibility of recording shelf life/expiration date within the system. A field identifying expiration date will be a top list item for any new inventory software system we look into for use by the warehouse."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Inventory Par Levels Not Used.**

- a. **Finding.** Inventory par levels were not maintained for regularly used food items. An inventory par level is a minimum quantity of a given item that must be kept on-hand. When the actual quantity falls below the par level, a new order should be placed. Realistic par levels can also minimize excess inventory in the warehouse. However, it is important to note that par levels only work if accurate records of on-hand quantities are maintained.

- b. **Recommendation.** The Chief Operating Officer should establish realistic par levels for regularly used food items. These levels should be used to determine when and how much is to be ordered.
- c. **Management Comments.** Management concurred and stated, “Management will investigate par level ordering and where it makes sense we will implement it. There were many challenges this year with all the new school programs and procurement procedures. This made it difficult to anticipate accurate expected usage which is important with implementing par level ordering. We hope the accurate usage we have experienced this year will significantly improve our estimates for next year and allow us to look at areas where par level ordering makes sense. We will never be able to have par level ordering for USDA commodity products as they are all delivered at one or two times during the year and we have to store the product until its time of usage.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

8. **Questionable OneSource Privileges.**

- a. **Finding.** We found that user privileges for OneSource access that did not always appear reasonable and necessary. As a business practice, and to promote internal control, only essential personnel should have the ability to adjust and receive inventory, and to change product prices. We reviewed the privileges for users who had access to the Central Kitchen module in OneSource, which allows the users to receive and adjust inventory. We also reviewed privileges for users who had access to the Central Office module, which allows staff to change the cost of individual products.

We found that 23 of 38 users in the Central Kitchen had access to modify inventory levels. We also found that 22 of 34 users in the Central Office had access to change inventory prices. Users with access included two warehouse truck drivers, 5 operations coordinators, an accounting analyst, and the Finance Department's Controller. Additionally, user profiles were active for two employees who were no longer with the District or with Student Nutrition. Furthermore, generic user profiles were active for user names such as "The Bakery", "The Cooks", and "Pre Pack."

By giving non-essential personnel access to modify inventory, the integrity of data in OneSource may be compromised. In addition, a user may inadvertently modify the data, without management knowing. Limiting user access may also make it easier for management to resolve issues and promote accountability with staff.

- b. **Recommendation.** The Chief Operating Officer should discontinue allowing non-essential personnel to have access to modify and receive inventory, and to change product prices in OneSource.
- c. **Management Comments.** Management concurred and stated, "Management agrees all non-essential personnel should be removed from having access to change anything in the inventory system. We have been provided a list of all employees with current access, have determined all non-essential personnel, and IT has removed them from access to the system. IT will also be analyzing read only access options for certain employees."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

9. **Inadequate Warehouse Procedures.**

- a. **Finding.** The warehouse lacked adequate written operating procedures. Many of the problems identified in this report could have been avoided with proper procedures. Procedures could include topics such as: Receipt of Goods, Issue of Goods, Return of Issued Inventory Goods, Handling of Surplus Goods, and Expiration Dates.
- b. **Recommendation.** The Chief Operating Officer should develop and implement operating procedures for the warehouse covering the main functions of the warehouse operation.
- c. **Management Comments.** Management concurred and stated, “Management agrees not all warehouse procedures are written and followed across the workforce and department. Written procedures for all main warehouse functions will be completed by the end of the school year and all employees will be trained on them so that they may be implemented at the start of the new fiscal year.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

10. **Physical Security at Warehouse Deficient.**

- a. **Finding.** The food warehouse was not secured to prevent unauthorized access. There are four doors into the warehouse that remain unlocked during the week. Two doors, which are accessible from the parking lot, are not visible to the warehouse office. The other two doors located by the loading dock are also unsecured and open. None of the doors have cameras or other warning devices to alert staff that someone entered the warehouse. The warehouse also has

unrestricted access to food service staff and anyone else entering from the food preparation area. In addition, the refrigeration repair section and break room are located inside the warehouse. Without proper security, items stored in the warehouse can be subject to theft, vandalism and other unauthorized use.

- b. **Recommendation.** The Chief Operating Officer should strengthen physical security of the food warehouse by, as a minimum, securing all doors into the warehouse to unauthorized entry, considering installing cameras at all points of entry, and isolating the refrigeration repair section from the food warehouse.
- c. **Management Comments.** Management concurred and stated, “Management agrees we need to strengthen the physical security of the entire building and look to minimize unauthorized entry. We will begin to keep the East and North side warehouse doors locked. We will explore putting warning devices on the two doors on the loading dock to alert the office when the door is opened. We will check with Guardian Security on the availability of getting notified when the building is accessed after hours and we will look into the availability and cost of installing cameras at all entrances to the building to monitor access.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

11. **Personal Goods Comingled With Warehouse Inventory.**

- a. **Finding.** Personal employee goods were not always segregated from warehouse inventory. For example during our inventory count, we saw two opened cases of Kirkland brand water bottles, used by staff, which were stored in the same

refrigerator as warehouse inventory. One case had an employee's name written on it, and the other case was stored on an open shelf, along with personal drinking cups.

The U.S. Department of Agriculture recommends setting and enforcing policies that define the personal items food service employees may and may not have in the food production or food service areas. The practice of comingling personal food and drinks with warehouse inventory increases the perception of theft and misappropriation, especially when the items are identical to warehouse products and physical inventory counts yield variances. Further, prohibiting the mixed use of personal goods and District assets in warehouse locations will not only protect District assets, but will protect the employee as well.

- b. **Recommendation.** The Chief Operating Officer should prohibit staff from storing personal food items in warehouse locations by designating a storage space outside of food service operations.
- c. **Management Comments.** Management concurred and stated, "Management agrees personal food items should not be comingled with warehouse inventory and we have been taking steps to minimize this over the last year. We will require all personal food items to be stored in an employee refrigerator or freezer in the break area. No personal food products will be allowed to be comingled with Student Nutrition inventory."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

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Anchorage School District
April 9, 2015

Discussion With Responsible Officials. The results of this audit were discussed with appropriate District officials.

Audit Staff:

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