

ASD INTERNAL AUDIT REPORT

2018-03

Student Nutrition Warehouse Inventory Controls

Anchorage School District

October 19, 2018

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Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

October 19, 2018

Anchorage School District Superintendent and Members of the School Board:

I am pleased to present for your review **ASD Internal Audit Report 2018-03; Student Nutrition Warehouse Inventory Controls; Anchorage School District**. 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 the receiving, storing, issuing, and accounting of items in the Student Nutrition Department Warehouse. To achieve our objective, we interviewed Student Nutrition Department staff to identify internal controls and responsibilities for managing inventory. We also conducted our own inventory of selected items and reviewed inventory adjustments.

Based on our review, we found that inventory controls and procedures at the Student Nutrition Department Warehouse need improvement. Specifically, on-hand inventory balances in OneSource were not accurate. In addition, food safety procedures were not always followed in the Student Nutrition Department Warehouse and expiration dates were not always used to manage the items stored in the warehouse. Furthermore, while some organizational improvements had been made in the dry storage area, the freezer was not properly organized and personal goods were not always segregated from warehouse inventory. Finally, the warehouse location field in OneSource was not used to record where items were located, the food warehouse was not secured to prevent unauthorized access, and the warehouse lacked adequate written standard operating procedures.

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

Michael Chadwick, CIA, CICA
Director, Internal Audit



Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

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ASD Internal Audit Report 2018-03
Student Nutrition Warehouse Inventory Controls
Anchorage School District

Introduction. The Student Nutrition Department (Student Nutrition) maintains a warehouse with almost 300 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 teriyaki chicken with oriental rice and chili. The Central Kitchen operates adjacent to the warehouse. Student Nutrition uses OneSource software to manage the warehouse inventory. Annual physical inventory counts are conducted to check the validity of records in OneSource.

Objective and Scope. The objective of this audit was to determine the adequacy of internal controls for the 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.

We conducted this performance audit in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review. 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. The audit was performed during the period of May 2018 through August 2018. The audit was requested by the Anchorage School Board Finance Committee.

Overall Evaluation. Inventory controls and procedures at the Student Nutrition Warehouse need improvement. Specifically, on-hand inventory balances in OneSource were not accurate. In addition, food safety procedures were not always followed in the Student Nutrition Warehouse and expiration dates were not always used to manage the items stored in the warehouse. Furthermore, while some organizational improvements had been made in the dry storage area, the freezer was not properly organized and personal goods were not always segregated from warehouse inventory. Finally, the warehouse location field in OneSource was not used to record where items were located, the food warehouse was not secured to prevent unauthorized access, and the warehouse lacked adequate written standard operating procedures.

FINDINGS AND RECOMMENDATIONS

1. OneSource Inventory Records Not Accurate.

- a. Finding.** On-hand inventory balances in OneSource were not accurate. As a result, inventory balances found in OneSource were nearly impossible to audit. On May 27, 2018, warehouse staff conducted a full physical inventory. On July 3, 2018, we conducted our own sample inventory counts. However, we were unable to reconcile our physical counts to OneSource records because warehouse staff deleted the entire inventory database and were in the process of entering inventory counts from their May 27, 2018, physical inventory. Due to the absence of inventory balances in OneSource, we used their May 27, 2018, physical inventory and made adjustments, based on a review of receiving and issuance reports, to reconstruct inventory balances. The following table contains examples of some of the discrepancies we identified:

Inventory Discrepancies July 2018

<u>Product (In Cases)</u>	<u>5/27/18 Physical Inventory</u>	<u>Adjustments: 5/28/18 to 7/3/18</u>	<u>Total</u>	<u>7/3/18 Auditor Inventory</u>	<u>Discrepancy Over/(Short)</u>
Graham Crackers	1,330	89	1,419	1,259	(160)
Meal Beef and Cheese	205	-66	139	112	(27)
Applesauce Cup	2,711	110	2,821	2,667	(154)
Cereal Frost Choc Mini Wheats	313	73	386	422	36
Fruit Raisin Strawberry	255	0	255	235	(20)

Source: Warehouse records and Auditor physical inventory conducted on July 3, 2018

On August 16, 2018, we again counted the five items above. Only one of the inventory items reconciled to OneSource records.

In addition to deleting the entire inventory database and not entering current inventory counts, other causes that contributed to inaccurate inventory balances included:

- *Kitchen Inventory Not Always Entered* – There was no assurance that inventory used for kitchen production was entered into OneSource. Specifically, according to kitchen management, inventory adjustments were made manually into OneSource by warehouse management after production. However, warehouse workers only recently started using a manual log to record what was taken to the kitchen and what was returned to the warehouse. According to warehouse management, the log may be missing entries.
- *Kitchen Product Not Entered into Inventory* – Food products made at the kitchen were not entered into inventory in OneSource. However, when these products were issued to the schools, the issued quantities were deducted from inventory, resulting

in a negative inventory balance in OneSource. The negative inventory counts grew larger every time the products were issued to the schools.

- *Orders Sometimes Generated without Inventory* – Warehouse staff sometimes generated pick tickets when there was no inventory for the product, but they expected to receive the product. For example, OneSource inventory records showed 287 cases of oranges leaving the warehouse on January 29, 2018, but the oranges were received the next day. OneSource reports then showed 307 cases of oranges were received on March 28, 2018, but these oranges left the warehouse the day before, under a different product identification number due to input error. As a result, negative inventory balances were created and manipulated under two different product identification numbers. In summary, shipping orders for the oranges were created before they were received and tracked under two different product identification numbers in OneSource.

A similar condition was reported in ASD Internal Audit Report 2015-02.

- b. **Recommendations.** The Director of Student Nutrition should ensure that:
- 1) Physical inventory counts are recorded into OneSource in a timely manner.
 - 2) Food products removed from inventory by the kitchen are entered into OneSource.
 - 3) Unused food products returned by the kitchen are entered into OneSource.
 - 4) Food products made by the kitchen are entered into OneSource.
 - 5) Pick tickets are generated only when inventory is available.
- c. **Management Comments.** Management stated, “Student Nutrition (SN) concurs with the specific findings of the audit; but the day-to-day throughput of food items obligates SN staff to apply non-standard accounting methods to mitigate distorted data. The department identified a perpetual inventory issue in One Source in Oct 2017 and engaged Horizon Software to resolve. Due to the pending year-end close out and

Horizon's inability to rectify the problem, warehouse staff used the wall-to-wall inventory process in OneSource to remove all of the quantities on hand and replaced them with the values from the wall-to-wall inventory conducted at the end of May. In order to prevent discrepancies during an inventory, the warehouse must freeze activity on the line(s) in order to keep dues-in and out from skewing the balance. Because receipts and issues occur on a daily basis it is impossible to achieve a baseline accounting and this can result in perceived discrepancies.

“Student Nutrition concurs with the recommendation to promptly enter items issued from the warehouse to the central kitchen for preparation of end-product and then return the product to inventory for issuance to schools. The OneSource production module does not accurately calculate required ingredient quantities for SN-prepared food items. SN evaluated this matter and chose to correct the inaccuracies by adjusting the products out of inventory when sent to the kitchen. Component products used and excess returned to inventory by the kitchen are being manually adjusted out of and into inventory by a Supervisor or Lead. The warehouse and Central Kitchen staff maintain written logs as a work-around to the shortfalls in the production module of the OneSource program. SN implemented a monthly reconciliation process to better capture possible inventory discrepancies and correct issues promptly.

“In certain circumstances, especially with regard to fresh produce, SN generates pick tickets before the product is received. In order to build the shipments for delivery to schools, SN allocates the items to the shipment build before receipt in anticipation of the item arriving. For example, produce pick tickets are printed on Thursday but the produce is not received until Monday morning. This practice enables SN to sort the produce and have it ready to deliver Monday afternoon.”

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

2. **Food Safety Procedures Not Always Followed.**

- a. **Finding.** Food safety procedures were not always followed in the Student Nutrition Warehouse. For example, we observed toxic chemicals stored above and beside food products. Food was also found directly on the floor in the warehouse freezer. According to the Hazard Analysis and Critical Control Points (HACCP) plan for the Anchorage School District's Student Nutrition Warehouse and Central Kitchen, cleaning supplies and chemicals are to be "... completely separated from all food, dishes, utensils, linens and single use items." Food stored in the freezer is to be on "... clean shelving or pallets that are at least 6 inches off the floor." There is a risk that student health could be impacted if contaminated food is consumed.
- b. **Recommendation.** The Director of Student Nutrition should ensure compliance with the HACCP plan.
- c. **Management Comments.** Management stated, "SN concurs with this finding. Department leadership is conducting corrective training with warehouse staff, and is implementing procedures for temporary storage and a deliberate inspection program to ensure proper segregation of food and non-food items.
- "Regarding food found on the freezer floor, SN concurs with the findings of the auditor. During the inspection, there were some items returned from schools and placed directly on the floor, due mainly to a space issue. The department retrained staff to ensure all employees understand the necessity of proper storage. The Food Safety Manager is also tasked to conduct more frequent inspections."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendations.

3. Food Expiration Dates Not Always Used.

- a. **Finding.** Expiration dates were not always used to manage the items stored in the warehouse. Since expiration dates were not entered into the OneSource inventory records, there was no reliable way for staff to locate the products closest to expiration. Warehouse staff sometimes wrote expiration dates on the food pallets when received, but this was not done consistently. Consequently, the oldest items or items close to the expiration date were not always issued first. Accurately documenting expiration dates will help manage items stored in the warehouse and minimize spoilage and waste. A similar condition was reported in ASD Internal Audit Report 2015-02.
- b. **Recommendation.** To properly manage items stored in the warehouse and minimize waste, the Director of Student Nutrition should actively use product expiration dates to ensure that the oldest items are used first.
- c. **Management Comments.** Management stated, “Concur. The Department Food Safety Manager does conduct periodic review of the warehouse. He routinely evaluates items on hand and if necessary can extend the shelf life of items as long as specific conditions are met. He will increase monitoring in the warehouse to ensure labeling is updated with an extended expiration date and ensure it is consumed as soon as possible.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

4. Warehouse Not Properly Organized.

- a. **Finding.** While some organizational improvements had been made in the dry storage area, the freezer was not properly organized. As a result, we were unable to conduct inventory counts in the freezer. For example, several aisles were completely blocked

and inaccessible. In addition, there were many pallets of food product without labels. A similar condition was reported in ASD Internal Audit Report 2015-02.

According to staff, schools had returned food products at the end of the school year in May 2018. Some of this product was placed in the freezer. However, as of July 3, 2018, the food product still had not been organized, even though there were empty shelves where food product could be placed.

- b. **Recommendation.** The Director of Student Nutrition should ensure organization of the warehouse freezer section. Items should be clearly labeled, sorted logically and easily accessible.
- c. **Management Comments.** Management stated, “The Student Nutrition Department agrees with the auditor regarding the organization of the warehouse. The Student Nutrition Center floor plan does not allow for a dedicated receiving area for arriving items. This obligates warehouse staff to temporarily place pallets in the aisles between storage rows until personnel can receive the items and place them in their permanent locations.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

5. **Personal Goods Commingled With Warehouse Inventory.**

- a. **Finding.** Personal goods were not always segregated from warehouse inventory. During our observation and sample counts, unlabeled personal items were found to be stored in the cooler and freezer. For example, plastic grocery bags with food and disposable containers were found in the cooler section and two ice chests with vacuum-packed fish were found in the freezer section. In addition, an open box of sugar cookies,

that appeared to be District goods, was placed on top of the open ice chests, giving the impression that they belonged with the personal items.

The practice of commingling personal food with warehouse inventory increases the perception and possibility of theft and misappropriation. Prohibiting staff from storing personal goods with warehouse items will not only help protect District assets, but will protect the employee as well. Furthermore, there is potential for contamination of warehouse items from personal items not being handled properly. A similar condition was reported in ASD Internal Audit Report 2015-02.

- b. **Recommendation.** The Director of Student Nutrition should prohibit staff from storing personal items in warehouse locations by designating a storage space outside of food service operations.
- c. **Management Comments.** Management stated, “Concur. The department will re-emphasize to staff that no personal items are allowed in food service storage areas. Leaders will conduct routine inspections and make corrections as appropriate.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

6. **Warehouse Locations Not Used.**

- a. **Finding.** The warehouse location field in OneSource was not used to record where items were located. Warehouse staff stated that it would be a cumbersome and ineffective process since locations would have to be manually updated every time an item was moved. However, without accurate and specific warehouse locations, retrieving items from the warehouse was inefficient and resulted in items being stored in numerous locations. For example, when we conducted our inventory count, we found

cases of applesauce cups stored in 45 different locations and cases of graham crackers stored in 11 different locations. Consequently, it was difficult to ensure that the oldest product was used first. A similar condition was reported in ASD Internal Audit Report 2015-02.

- b. **Recommendation.** The Director of Student Nutrition should ensure that 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 due to spoilage.
- c. **Management Comments.** Management stated, “Concur. SN aspires to standardize storage locations for all items. Software limitations and space constraints impede achieving this desired outcome. First, OneSource does not have scanning capability to facilitate location accuracy, and SN is not sufficiently staffed to commit a warehouse employee to manually input data into the system. Second, the warehouse lacks overall storage capacity to dedicate space to specific products and commodities. SN will continue to work towards attaining more standardized locations.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

7. **Physical Security at Warehouse Needs Improvement.**

- a. **Finding.** The food warehouse was not secured to prevent unauthorized access. The warehouse has unrestricted access to food service staff and anyone else entering from the food preparation area. The warehouse has no gate or other means to prevent access. In addition, staff work locations do not allow for direct observation of the warehouse

entrance. Finally, there are no cameras or other warning devices to alert staff that someone has entered the warehouse. Without proper security, items stored in the warehouse are subject to theft, vandalism and other unauthorized use. A similar condition was reported in ASD Internal Audit Report 2015-02.

- b. **Recommendation.** The Director of Student Nutrition should consider strengthening physical security of the warehouse by installing cameras at all entry points and moving work stations to provide visible presence at the entrance.
- c. **Management Comments.** Management stated, "Concur. Student Nutrition recognizes the need for surveillance cameras and other physical security improvements to better secure the building. This shortcoming extends to other ASD activities in that complex. The department submitted Work Orders for camera installation on April 17th, 2018. SN leaders will integrate department wide security training into current safety training to improve overall awareness."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

8. **Inadequate Warehouse Procedures.**

- a. **Finding.** The warehouse lacked adequate written standard operating procedures. Many of the problems identified in this report could have been avoided with more comprehensive procedures. Procedures could include topics such as: Issuance of Goods, Receipt of Goods, Return of Issued Inventory Goods, Quantity Adjustments, and Expiration Dates. A similar condition was reported in ASD Internal Audit Report 2015-02.

- b. **Recommendation.** The Director of Student Nutrition should develop and implement operating procedures for the warehouse covering the main functions of the warehouse operation.
- c. **Management Comments.** Management stated, "Concur. SN has been using the best practices guide provided by OneSource. SN will develop more specific SOP's for Student Nutrition."
- 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 September 13, 2018.

Audit Staff:
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