

Municipality
of
Anchorage



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OFFICE OF THE INTERNAL AUDITOR

April 24, 1996

**Internal Audit Report 96-04
1995 Parts and Fuel Inventory
Municipal Light and Power**

Introduction. The Municipality of Anchorage maintains an inventory of parts and fuel at Municipal Light and Power (ML&P). The inventory was counted in November 1995 and the financial records were adjusted to the physical counts. ML&P uses the Municipal Financial Information System's (FIS) inventory subsystem.

Scope. The objectives of this audit were to determine if the physical inventory of parts and fuel was reasonably accurate and correcting adjustments were properly entered in the financial records. The audit was conducted in accordance with generally accepted government auditing standards and accordingly, included tests of inventory counts, accounting records and such other auditing procedures as we considered necessary in the circumstances. The audit was performed during the period of November through December 1995 and adjusting entries were verified during February 1996.

Overall Evaluation. Total inventory at ML&P was recorded at \$3,576,127 which included parts and fuel. The value of the warehouse inventory was based on a

weighted average unit cost and the physical inventory was performed in November 1995. Fuel inventory was measured in December 1995 and valued at book cost. Based on the results of our review, we found the inventory to be fairly stated in all material respects. However, inventory counts were not always accurate and the procedures for issuing and returning inventory items were not always followed, resulting in discrepancies between the amount of inventory on hand and the perpetual records.

FINDINGS AND RECOMMENDATIONS

1. Inventory Counts Not Accurate.

- a. Finding.** Inventory counts were not always accurate. Our inventory test counts of 42 selected items revealed a 10% error rate. The inventory teams were made up of ML&P employees from other sections. We found that inventory procedures were not always followed by the count teams. For example, one of the errors occurred because the count teams had not individually counted the units, but had recorded a quantity documented on the inventory item. In the other three instances, inventory items were located in more than one bin location but only items located in one bin location were counted. Appropriate adjustments were made to correct the inventory balances for these items during the inventory.

- b. **Recommendation.** To facilitate year-end physical inventories of the warehouse, ML&P should consider contracting out the inventory process.
- c. **Management Comments.** Management stated, "Due consideration will be given to the feasibility of contracting out the inventory process."
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Perpetual Inventory Records Did Not Reflect Actual Quantities on Hand.**

- a. **Finding.** Perpetual inventory balances did not agree with the physical count for 30% of the inventory items. Even though the dollar impact was not significant, this condition was an indicator of several potential problems. As stated in the finding above, the inaccuracy of inventory counts was a direct cause for some of the discrepancies. The physical inventory contained a 10% error rate yet the inventory records were adjusted to the physical count. Second, this condition is an indication that all warehouse transactions were not documented. We recognize that ML&P maintains an open warehouse concept where by maintenance crews have the ability to access the warehouse during non-business hours. This error rate indicates that maintenance personnel do not

always document issues and returns when warehouse personnel are not present.

b. **Recommendation.** Procedures should be strengthened to improve the accuracy of the physical inventory and better document warehouse transactions.

c. **Management Comments.** Management stated, "ML&P has taken this recommendation under advisement and is seeking ways to improve the processes currently used. The finding of the perpetual inventory and the physical count being in disagreement by 30% prior to reconciliation of the count, is of course an item of concern to ML&P, even though the majority of the items in question were of insignificant monetary value. Following re-count and reconciliation by persons knowledgeable of and able to properly identify individual inventory items, the difference was narrowed to approximately 13 percent. Additionally, the bottom line difference in the inventory following reconciliation was \$76.80.

"Anticipated improvements in automated support equipment along with an increased emphasis on warehouse inventory control should preclude future concerns related to inventory control and the annual count. Your suggestion to convert many of the items to "direct charge" is taken under advisement. We agree that making such a conversion should significantly reduce the margin for error."

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- 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 March 8, 1996.

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