Audit of Warehouse Inventory Management

Follow-Up Review

The City has begun working to obtain a new Enterprise Resource Planning software system to streamline internal processes, including asset and inventory management. Additionally, new standard operating procedures have improved documentation of the City's inventory management processes; however, auction proceed reconciliation procedures still need to be developed. Further, the Warehouse has established a periodic cycle count process to ensure all inventory is counted at least annually.

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Follow-Up at a Glance

Why we did this Follow-Up:

This report is intended to provide information on what changes have been made in response to the Audit of Warehouse Inventory Management issued in August 2022. The original audit evaluated the controls implemented to ensure warehouse inventory was adequately managed and safeguarded as well as the inventory ordering, distribution, monitoring, and disposal processes. This follow-up review was included on the City's Fiscal Year 2024-2025 Annual Internal Audit Plan as approved by the City Council.

What we Found:

The Warehouse Division has implemented several standard operating procedures to better document the inventory management process, including receiving and stocking inventory, processing inventory orders and returns, and managing auctioned inventory. However, auction payment reconciliation procedures need to be established. In addition, the City begun working to obtain a new Enterprise Resource Planning software system, which should include enhancements for asset and inventory management. Further, the Warehouse Division has established a standard cycle count schedule to ensure that 100 percent of inventory is counted annually. Finally, the City's disposal criteria have been updated to align with the Finance Department's fixed asset criteria although periodic awareness to City personnel regarding the City's surplus disposal processes needs to be enhanced. The status of each recommendation is summarized below:

Recommendation	Mgmt. Response	Status
1. Evaluate the business need to adopt a software for monitoring low stock inventory quantities and reduce the risk of critical items being out-of-stock.	Concurred	Implemented
2. Develop standard procedures to detail the processes for receiving and stocking inventory orders.	Concurred	Implemented
3. Consider acquisition of an inventory ordering software to streamline inventory orders.	Concurred	Implemented
4. Develop standard procedures to detail the processes for completing customer orders.	Concurred	Implemented
5. Provide periodic training to staff over Warehouse Return procedures and update the Warehouse Internal Return SOP to include required documentation and retention location(s).	Concurred	In Progress
6. Develop a process to manage key controls to the Warehouse and record employee key access, including logging when an employee receives and returns a key.	Partially Concurred	Implemented
7. Establish a standard cycle count schedule to ensure cycle counts cover 100 percent of warehouse inventory.	Partially Concurred	Implemented
8. Periodically provide reminders to City personnel to promote awareness of the surplus disposal processes related to destructions, donation, and auction.	Concurred	In Progress
9. Evaluate the asset destruction criteria to determine if it should be more closely aligned with the Finance Department's fixed asset criteria.	Concurred	Implemented

Audit report translations may be requested by emailing InternalAudit@CityofDenton.com.

10. Develop procedures outlining the internal Warehouse Auction process including auction preparation, required documentation to be retained for each auction and pick-up, and auction payment reconciliation.	Concurred	In Progress

Recommendation Status Update

This report summarizes the Audit of Warehouse Inventory Management recommendations, management responses, and the City Auditor's Office's follow-up findings, which describe to what extent City management has implemented Internal Audit's recommendations since the publication of the original report in August 2022.

Manual Inventory Ordering Processes May Impact Efficiency

1. **Evaluate the business need to adopt a software for monitoring low stock inventory quantities and reduce the risk of critical items being out-of-stock.**
   Management Response: Concur
   Warehouse Division Comments: The Warehouse is actively looking at ways to improve processes. Warehouse is interested in adopting a software that will provide comprehensive inventory management including tracking stock levels. The City is considering a new ERP, and the Warehouse will be included in the process.

   Audit Follow-Up Finding: Implemented
   The City is currently undergoing a needs assessment for a new City-wide Enterprise Resource Planning software system. This system is expected to replace current systems and streamline internal processes, including monitoring low stock inventory and critical items for the Warehouse Division. The City is expected to procure the new software during 2025 and begin implementation in 2026.

2. **Develop standard procedures to detail the processes for receiving and stocking inventory orders.**
   Management Response: Concur
   Warehouse Division Comments: The Warehouse will develop a SOP for receiving and stocking items. This SOP will also outline how to file supporting documentation for the orders.

   Audit Follow-Up Finding: Implemented
   The Warehouse Division has developed and implemented a standard operating procedure that adequately details the processes for receiving and stocking inventory orders for Warehouse staff, including comparing purchase orders and shipping documents, recording physical counts, and retaining needed documentation.

   Based on a review of a statistical sample of 90 received and processed inventory orders, all but two had all required support documentation. Of the remaining two inventory orders, one was missing the vendor receipt and no documentation for the remaining inventory order could be located. Based on a comparison between the results from the review of inventory orders

from the original audit and this follow-up review, the Warehouse Division appears to have improved the process for managing inventory orders and ensuring documentation and employee verification is properly recorded and retained as shown in Table 1.

Table 1: Inventory Order Exceptions Summary

Order Data	Original Audit		Follow-Up Review	
	Quantity	Percentage	Quantity	Percentage
No Documentation Located[1]	5	5%	1	1%
No Vendor Receipt	0	0%	1	1%
No Verification of Quantity Received	2	2%	0	0%
Inaccurate Quantity Recorded	2	2%	0	0%

Warehouse Provides Generally Effective Customer Service; Some Documentation of Pickups & Returns Missing

3. **Consider acquisition of an inventory ordering software to streamline inventory orders.**
   Management Response: Concur
   Warehouse Division Comments: The Warehouse is actively looking at ways to improve processes and is interested in implementing a software that will provide comprehensive inventory management including a streamlined ordering process. The City is considering a new ERP, and the Warehouse will be included in the process.

   Audit Follow-Up Finding: Implemented
   As noted in Recommendation 1, the City is currently undergoing a needs assessment for a new City-wide Enterprise Resource Planning software system that is expected to replace current systems and streamline inventory ordering for the Warehouse Division. Software system implementation is expected to begin in 2026.

4. **Develop standard procedures to detail the processes for completing customer orders.**
   Management Response: Concur
   Warehouse Division Comments: The Warehouse will review and update the current SOPs for customer orders and include an outline of the process.

   Audit Follow-Up Finding: Implemented
   The Warehouse Division has developed and implemented standard operating procedures that adequately detail the processes for

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[1] Inventory purchase order and vendor receipt unable to be located. Due to the lack of documentation, employee verification of the inventory quantity received is not recorded so accuracy of the inventory quantity recorded in the inventory system cannot be confirmed.

completing customer orders for Warehouse staff, including completing the Stock Requisition form and pick ticket, verifying order quantities and prices, requiring customer signatures upon receipt, and retaining needed documentation.

Based on a review of a statistical sample of 95 processed customer orders, all support documentation was appropriately retained, and customer signatures were recorded to verify receipt of inventory. Based on a comparison between the results from the review of customer orders from the original audit and this follow-up review, the Warehouse Division appears to have improved the process for managing and completing customer orders as shown in Table 2.

Table 2: Processed Customer Orders Exception Summary

Missing Documentation	Original Audit[2]		Follow-Up Review	
	Quantity	Percentage	Quantity	Percentage
Stock Requisition Form	22	16%	0	0%
Pick Ticket	16	12%	0	0%
Customer Signature[3]	32	42%	0	0%
All Required Items	16	12%	0	0%

5. **Provide periodic training to staff over Warehouse Return procedures and update the Warehouse Internal Return SOP to include required documentation and retention location(s).**
Management Response: Concur
Warehouse Division Comments: Warehouse Management will implement a standardized and centralized filing system for returns. The current SOP will be revised to reflect the new process. Warehouse staff will be trained during the bi-weekly meetings.

Audit Follow-Up Finding: In Progress
The Warehouse Division has updated the standard operating procedure to detail the return process for Warehouse staff. This standard operating procedure requires staff to compare the customer's Return Form to the original pick ticket to verify inventory quantities and pricing to ensure an accurate refund amount is issued; and to record the reason for the return. This standard operating procedure also standardizes the process to file and retain all support documentation for each return.

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[2] During the original audit, it was noted the Warehouse Division updated internal processes beginning July 2021. Testing results during the original audit were separated between pre-July 2021 and post-July 2021 to show the impact of the process improvements. The testing results for post-July 2021 from the original audit were included on this table for comparison.
[3] This excludes customer signature on pick-tickets for walk-in orders.

Based on a review of a statistical sample of 81 processed returns, support documentation for six percent could not be located, and an additional six percent of returns were missing a Return Form. The remaining 88 percent of returns had all required support documentation. Based on a comparison between the results from the review of processed returns from the original audit and this follow-up review, the Warehouse Division appears to have improved the process for managing returns and retaining support documentation as shown in Table 3.

Table 3: Warehouse Returns Exception Summary

Status	Original Audit[4]	Follow-Up Review
No Documentation Located[5]	8%	6%
No Return Form	46%	6%
No Pick Ticket	21%	0%

According to Warehouse management, training on the updated return procedure was provided to all Warehouse staff during a weekly meeting. Furthermore, Warehouse management stated staff are trained when a standard operating procedure is created or revised, and all new employees are trained on current processes upon hire. However, the documentation for six percent of the most recent return sample could not be located indicating additional staff training over internal processes may be required.

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[4] As previously noted, the testing results for post-July 2021 from the original audit were included on this table for comparison.
[5] This includes a Return Form, Pick Slip, or Monthly Recon Expense Report.

Warehouse Physical Safeguards Appear Effective; Not All Items Verified Annually

6. **Develop a process to manage key controls to the Warehouse and record employee key access, including logging when an employee receives and returns a key.**

   Management Response: Partially Concur

   Warehouse Division Comments: The primary security system at the Warehouse is the alarm system keypad. Individuals entering the Warehouse must use a keycode to disable the alarm. If an incorrect keycode is used, the alarm will activate, and the Warehouse Manager will be notified immediately. The alarm company also notifies the Police Department of an alarm activation. The keycode is changed annually or in the event of employee turnover. Additionally, the Warehouse is under 24/7 video surveillance, with capability to remotely access live camera feeds and past footage on demand. The key is used as a secondary form of access. Rekeying a lock can be done if a specific threat is identified, however, a key holder will still need the alarm keycode for uninterrupted access. Warehouse staff will work with Facilities on reviewing best practices for security.

   Audit Follow-Up Finding: Implemented

   The Warehouse Division has created a key log to track who has a key and the date it was returned. Warehouse keys are also now engraved with a unique identifier that allows each key to be assigned to an employee and documented on the key log for tracking purposes. Based on review of the Warehouse's key log as of October 2024, each employee with an assigned key was a current Warehouse employee.

   Additionally, the Warehouse Division is coordinating with the Facilities Division to replace its physical keys with badge readers. This project should be completed by the end of 2024.

7. **Establish a standard cycle count schedule to ensure cycle counts cover 100 percent of warehouse inventory.**
    Management Response: Partially Concur
    <u>Warehouse Division Comments:</u> Warehouse Management will develop and implement a process that improves tracking of bi-annual cycle counts performed by the Warehouse Specialist II's to ensure that 100% of inventory is being covered on scheduled cycle counts. When items are no longer needed or being discontinued, they go through a phase out process where the item is counted, and a disposal process is immediately initiated. Phase out inventory is not included on bi-annual cycle counts but is being counted through a separate tracking process. This allows Warehouse staff to initiate a phase out at any time and the majority of phased out times are disposed of prior to the next cycle count.

    Audit Follow-Up Finding: Implemented
    The Warehouse Division has implemented a standard cycle count schedule to ensure 100 percent of inventory items are counted annually. The Warehouse Manager assigns each Warehouse Specialist II eight Warehouse locations to conduct a full inventory weekly, including counting assigned inventory and recording cycle count results in the inventory system. Cycle counts and variances are also documented in the Warehouse Division's cycle count spreadsheet. Based on review of a judgement sample of 20 completed cycle counts, all cycle counts appeared to be documented appropriately and variances properly recorded in the inventory system to update inventory quantities.

    Additionally, beginning November 2024, the Warehouse Division has implemented a process to temporarily halt customer operations to conduct an annual count of all Warehouse inventory at one time. Based on review of the Warehouse's stock report and completed inventory counts, 100 percent of Warehouse inventory has been counted as of November 2024.

Item Disposal Processes Recently Centralized; City-wide Awareness of Disposal Process Could be Improved

8. **Periodically provide reminders to City personnel to promote awareness of the surplus disposal processes related to destructions, donation, and auction.**

   Management Response: Concur

   Warehouse Division Comments: Employee forums, emails, and department trainings have all been used to communicate the surplus disposal process. The Warehouse Manager presented a presentation in the December 2021 Employee Forum informing city personnel of the procedures. Staff will continue to utilize these and other identified platforms to provide periodic updates to City staff. Information on sustainability can be included.

   Audit Follow-Up Finding: In Progress

   The Warehouse Division provided a reminder about surplus disposal processes during the December 2021 employee forum; however, no additional awareness activities have been initiated. According to Warehouse management, they are planning to create a flyer for City employees with information about the City's surplus disposal processes.

9. **Evaluate the asset destruction criteria to determine if it should be more closely aligned with the Finance Department's fixed asset criteria.**

   Management Response: Concur

   Warehouse Division Comments: Warehouse will review the fixed asset criteria and update the asset destruction criteria for consistency across both programs.

   Audit Follow-Up Finding: Implemented

   The City's Procurement Manual was updated to require City departments to coordinate with the Finance Department for disposal of assets over $5,000 so fixed asset records can be updated appropriately per the City's Fixed Asset Policy.

10. **Develop procedures outlining the internal Warehouse Auction process including auction preparation, required documentation to be retained for each auction and pick-up, and auction payment reconciliation.**

    Management Response: Concur

    Warehouse Division Comments: Warehouse Management has drafted a Standard Operating Procedure for Internal Auction Processes. This document was not finalized due to additional changes in processes at the time the SOP was drafted. Warehouse Management will revise and finalize the Internal Auction SOP to reflect current practice to conduct auctions.

Audit Follow-Up Finding: In Progress

The Warehouse Division has developed and implemented a standard operating procedure that generally details the processes for managing auctions for Warehouse staff, including preparing for the auction, verifying the buyer's identity, obtaining a signature upon pickup, and retaining needed documentation. However, it does not require auction payments to be reconciled.

Based on a review of all 16 auctioned items between April and September 2024, all support documentation was found except for two items. One buyer purchased the remaining two auctioned items on one receipt, but the buyer's signature was not obtained. Based on a comparison between the results from the review of completed auctions from the original audit and this follow-up review, the Warehouse Division appears to have improved the process for managing auctions, retaining support documentation, and ensuring auction buyer verification is completed as shown in Table 4.

Table 4: Auction Disposal Summary

Missing Data	Original Audit	Follow-Up Review
Auction Buyer Identification	14	0
Auction Buyer Signature	2	2[6]
Auction Receipt	1	0

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[6] These auctioned items were purchased and picked-up by the same auction buyer, so the auction receipt reflected both items although they were bid and purchased separately.

Audit Project Background

The City Auditor's Office is responsible for providing: (a) an independent appraisal[7] of City operations to ensure policies and procedures are in place and complied with, inclusive of purchasing and contracting; (b) information that is accurate and reliable; (c) assurance that assets are properly recorded and safeguarded; (d) assurance that risks are identified and minimized; and (e) assurance that resources are used economically and efficiently and that the City's objectives are being achieved.

Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. 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.

Management Responsibility

City management is responsible for ensuring that resources are managed properly and used in compliance with laws and regulations; programs are achieving their objectives; and services are being provided efficiently, effectively, and economically.

Objectives, Scope, and Methodology

The City Auditor's Office has completed a follow-up review of the Audit of Warehouse Inventory Management, which evaluated the controls implemented to ensure warehouse inventory was adequately managed and safeguarded, as well as the inventory ordering, distribution, monitoring, and disposal processes. This report is intended to provide a progress update on recommendations from the Audit of Warehouse Inventory Management.

Audit fieldwork was conducted during October and November 2024. The scope of review varied depending on the procedure being performed. The following list summarizes major procedures performed during this time:

➢ Reviewed documentation from the issued audit review to develop criteria including industry standards, best practices, policies, and procedures;

➢ Interviewed Warehouse, Procurement, and Facilities Department staff;

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[7] The City of Denton City Auditor's Office is considered structurally independent as defined by generally accepted government auditing standard 3.56.

➢ Reviewed new standard operating procedures related to receiving and stocking inventory, processing inventory orders and returns, and managing auctioned inventory;

➢ Reviewed a statistical sample of 95 processed customer orders, 90 Warehouse inventory orders, and 81 Warehouse returns and refunds from April through September 2024 to verify transactions were appropriately processed, recorded, and contained appropriate support documentation;[8]

➢ Reviewed the Division's key log to ensure Warehouse keys were assigned to current Warehouse employees;

➢ Reviewed a judgement sample of 20 completed cycle counts to determine whether cycle counts were appropriately documented and completed;

➢ Compared the Warehouse's inventory stock report to the report of counted inventory from January 2023 through November 2024 to determine whether 100 percent of Warehouse inventory had been counted;

➢ Reviewed updated asset destruction criteria in the City's Procurement Manual; and

➢ Reviewed the population of 16 surplus auction disposals from April through September 2024 to ensure auctions were properly managed and recorded, and appropriate support documentation retained.

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[8] Each sample size provides with 95 percent confidence that the true population statistic is with ±10 percent of the sample estimate.