

OFFICE OF THE CITY CONTROLLER



PUBLIC WORKS AND ENGINEERING DEPARTMENT

**NORTHEAST REGIONAL STREET AND STORM
SEWER MAINTENANCE CENTER**

**FOLLOW-UP OF THE UNANNOUNCED INVENTORY
AUDIT OF MATERIALS, SUPPLIES AND FIXED ASSETS**

Judy Gray Johnson, City Controller

Steve Schoonover, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

JUDY GRAY JOHNSON, CPA

July 28, 2003

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

SUBJECT: Public Works and Engineering Department
Northeast Regional Street and Storm Maintenance Center
Follow-Up of the Unannounced Inventory Audit of Materials,
Supplies and Fixed Assets (Report No. 03-04)

Dear Mayor Brown:

The City Controller's Office Audit Division has completed a Follow-Up of the Unannounced Inventory Audit of Materials, Supplies, and Fixed Assets report that was issued in October 2001. The findings and recommendations that were presented at the time of the report were distributed to the Mayor and City Council Members.

Our follow-up audit was designed to determine the progress the Public Works and Engineering Department has made towards implementation of the recommendations made in the original report. The follow-up audit consisted primarily of conducting an unannounced inventory count, on-site interviews with Department personnel and reviewing relevant documentation related to recommendations implemented.

My auditors concluded that the Department has not effectively implemented all the recommendations detailed in the previous report. Critical control weaknesses and exceptions exist resulting in inadequate physical security of inventory, document alteration to hide inventory variances, and slow moving inventory. Since we understand that alteration and falsification of government documents is a criminal act, we referred this matter to the Office of Inspector General.

Our understanding is that the City does not have an Administrative Policy regarding fraud. Corporate fraud has had a dramatic effect on the business, investment, and public accounting community during the past few years and has resulted in significant legislation and regulatory changes at the federal level. I believe that the City would benefit from a well publicized fraud policy. Employees and vendors that are aware that the City has a fraud policy and the consequences of committing fraud against the City would be less likely to defraud the City.

Development of a fraud policy would require your support and input. If you chose to implement such a policy, my office will be glad to assist in any way it can.

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The current findings and recommendations, the follow-up of prior report findings and recommendations, and the views of responsible officials are appended to the report as Exhibits I, II, and III respectively.

We appreciate the cooperation extended to our auditors by Department personnel during the course of their work.

Respectfully submitted,

A handwritten signature in cursive script that reads "Judy Gray Johnson".

Judy Gray Johnson
City Controller

xc: City Council Members

Albert Haines, Chief Administrative Officer

Stephen O. Tinnermon, Chief of Staff, Mayor's Office

Jon C. Vanden Bosch, Director, Public Works and Engineering Department

Philip Scheps, Ph.D., Director, Finance and Administration Department

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EXECUTIVE SUMMARY

Critical control weaknesses and exceptions exist resulting in inadequate physical security of inventory, document alteration to hide inventory variances, and slow moving inventory.

- We determined that a Material Requisition form had been altered and others may have been altered or falsified to conceal inventory shortages. Since we understand that alteration and falsification of government documents is a criminal act, we referred this matter to the Office of Inspector General (OIG). The OIG reviewed our evidence and is currently investigating the matter.
- By allowing operational personnel after hours access to inventory, Materials Management Branch (MMB) management has failed to ensure that it is properly safeguarding and issuing inventory. Inventory variances could be the result of errors, pilfering and theft, or legitimate unreported after hour's usages and returns.
- Conditions regarding inventory usage at McCarty have deteriorated since our last audit in 2001. The percentage of commodities on-hand exceeding a one-year supply increased from 48% to 68%, and now represents 87% of the value of the McCarty inventory. Further, slow moving commodities are a significant issue at all of PWE warehouses.

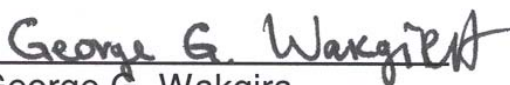
SCOPE AND PURPOSE

We have completed a follow-up audit of the findings and recommendations that were presented in the Public Works and Engineering Department's Northeast Regional Street and Storm Sewer Maintenance Center Report No. 01-03 (report) dated October 30, 2001. Our review was designed to determine the progress the Department has made towards implementation of the recommendations made to the Department in the original report.

The review consisted principally of conducting an unannounced inventory count, on-site interviews with Department personnel, analytical review, reviewing relevant documentation related to recommendations implemented, creating a compliance matrix categorizing the status of actions taken by management, and a report reflecting current findings and recommendations. The scope was limited to follow-up of the recommendations from the report. The review included examining the Public Works and Engineering Department's responses in detail to determine whether management considered the recommendations and strategies for implementation as presented in the report and whether progress was made since its issuance.

CONCLUSION


Based on the results of our follow-up audit, we conclude the Public Works and Engineering Department has not effectively implemented all the recommendations detailed in the previous report. Critical control weaknesses and exceptions exist resulting in inadequate physical security of inventory, document alteration to hide inventory variances, and slow moving inventory.



George G. Wakgira
Auditor-in-charge



Kenneth Teer
Audit Manager



Steve Schoonover
City Auditor

EXHIBIT I

CURRENT FINDINGS & RECOMMENDATIONS

ALTERATION AND FALSIFICATION OF CITY DOCUMENTS

BACKGROUND

The previous audit report, dated October 30, 2001, recommended that the Storm Sewer Section (Section) establish procedures to promptly and accurately record its warehouse receipts, issues and transfers. The report also recommended that differences between inventory records and actual quantities on-hand be adjusted only after review and approval by appropriate management.

Subsequent to our previous report, the PWE transferred responsibility for inventory management at 5500 McCarty from the Section to the Materials Management Branch (MMB). MMB had, and still has, Standard Operating Procedures (SOP) that complied with our previous recommendations.

On February 3, 2003, the Audit Division of the Controller's Office conducted an unannounced inventory count at the Northeast Maintenance Center located at 5500 McCarty Road. Many of our counts, which MMB personnel verified, did not agree with the balances on-hand in the Advantage 2000 inventory system. We attempted to resolve these differences by working with MMB; twenty of the 62 (32.3%) commodities we test counted remain unresolved.

MMB provided us with 13 Material Requisitions as support for several of the differences. We noted the requisitions were dated after February 3, 2003, thus they should not have caused the differences. We then met with MMB management to discuss this point. MMB management represented that the requisitions were for January issues, but the requisitions were not prepared until February. We attempted to confirm this representation by interviewing the field supervisors that authorized the requisitions.

The supervisors stated that the requisitions represented issues subsequent to February 3, 2003. Some of the supervisors stated that commodities not requested appeared to have been added to their requisitions, and one supervisor discussed being recently approached by MMB personnel to sign a Material Requisition for items that the supervisor had not requested.

By examining additional evidence, we determined that one Material Requisition document had been altered by adding commodities to the requisition.

FINDINGS

Based on the above, we determined that a Material Requisition form had been altered and others may have been altered or falsified to conceal inventory shortages. Since we understand that alteration and falsification of government documents is a criminal act, we referred this matter to the Office of Inspector General (OIG). The OIG reviewed our evidence and is currently investigating the matter.

Further, we understand that it is a common practice to use Material Requisitions to record inventory shortages at 5500 McCarty. Such actions are a circumvention of MMB's SOP to use Requests for Inventory

Adjustment forms to record inventory adjustments. By monitoring inventory adjustments, management can evaluate effectiveness in recording inventory transactions and safeguarding the inventory.

RECOMMENDATION

To minimize unauthorized alterations of Material Requisitions, the Department should either require authorizers (field supervisors) to void unused lines on the Material Requisition form or require MMB to revise the Requisition form and require the person picking up the goods (a recipient) to sign each line to indicate receipt of that particular commodity. The Department also needs to require recipients to obtain the pink copy of the signed Material Requisition form and return it to appropriate operating management so that they can confirm that MMB charges them only for requested items.

The Department should also require MMB management to record all inventory adjustments by using Requests for Inventory Adjustment in accordance with SOP 007. Under no circumstances should operational personnel sign a Material Requisition for items not requested. The Department should also monitor inventory adjustments to evaluate MMB's effectiveness in recording inventory transactions and safeguarding the inventory.

We recommend that PWE management discuss with the Mayor's Office the need for development of a written citywide fraud policy which should include a section on alteration and falsification of government documents. The City should provide the policy to all employees and require each employee to sign and date a document stating that they received, read, and understood the fraud policy. Additionally, the City should post the policy in places where City staff can read it.

The Department should implement the above recommendations at all PWE warehouses, not just 5500 McCarty. Upon completion of actions, if any, taken by the OIG, PWE management should determine whether further action is required.

INADEQUATE SECURITY OVER INVENTORY

BACKGROUND

The MMB is responsible for ensuring that it properly issues and safeguards inventory. A gated fence encloses the yard at 5500 McCarty. The inventory is stored inside a warehouse, under a covered fenced shed and in the yard. MMB personnel lock the warehouse at the end of the business day. However, in addition to several MMB personnel, selected operational personnel have keys to the warehouse. MMB personnel do not lock the covered fence area at the end of the business day. Thus, after hours, materials stored in the yard or the covered fenced area are readily accessible to anyone having access to the yard, whereas inventory in the warehouse is limited to MMB and operational personnel having keys.

MMB management represented to us that many inventory variances occur because 5500 McCarty is a 24/7 operation and that operational personnel

take items after hours without completing requisitions. The Public Works Maintenance Manager stated that 5500 McCarty was not a 24/7 operation and that the need for operational personnel to access inventory after hours would be rare (less than 5 times per year). He further stated that when the Department transferred responsibility for inventory management to MMB he indicated to MMB that on rare occasions his personnel might require after hours access to the inventory.

FINDINGS

By allowing operational personnel after hours access to inventory, MMB management has failed to ensure that it is properly safeguarding and issuing inventory. Inventory variances could be the result of errors, pilfering and theft, or legitimate unreported after hour's usages and returns. Under the existing circumstances, it would be difficult, if not impossible, to determine the cause of inventory variances. However, the Department should hold MMB management, not warehouse personnel or operating management, accountable for inventory variances resulting from after hours access.

RECOMMENDATION

It is imperative that MMB meet operational management's needs, while at the same time ensuring that inventory is properly issued and safeguarded. The Department should require MMB management and operational management to work together and devise a method to meet each other's needs.

One solution might be for MMB to secure the inventory and have MMB warehouse personnel on call in the event of an after hours emergency. Another solution might be for MMB to secure the inventory while operating management ensures that it adequately stocks its vehicles to meet after hour emergencies. The agreed to solution should be implemented at all PWE warehouses, not just 5500 McCarty

INVENTORY USAGE

BACKGROUND

In the previous audit we determined that in December 2000, 100 of the 210 (48%) commodities on hand at McCarty exceeded a one-year supply and recommended that the Section maintain its inventory at levels that could be consumed within a more reasonable period of time. At the time of our last audit, one Senior Storekeeper performed the Section's warehouse duties.

Using data obtained from the Strategic Purchasing Division's Cumulative Usage Report by Stock Item, we analyzed inventory usage at 5500 McCarty for the twelve months ending February 27, 2003. The results are in the table that follows:

Public Works and Engineering Department
 Northeast Regional Street and Storm Sewer Maintenance Center
Follow-Up of the Unannounced Inventory Audit of Materials, Supplies and Fixed Assets

EXHIBIT I

	NO OF ITEMS	12-MONTH USAGE IN \$	VALUE ON-HAND 2-27-2003	ON-HAND %	INVENTORY TURNOVER	SUPPLY ON-HAND IN YRS
	147	0.00	99,045	12.29%	0.00	Infinite
	25	17,687	422,765	52.46%	0.04	10 Yrs & Up
	116	49,936	179,272	22.25%	0.28	1 To 9.99 Yrs
Subtotal/Calculation	288	67,623	701,082	87.00%	0.10	10.37 Yr
	83	155,769	92,032	11.42%	1.69	.50 To .99 Yr
	50	63,188	10,833	1.34%	5.83	.01 To .49 Yr
	2	-398	1,868	0.24%	0.00	N/A
Subtotal/Calculation	135	218,559	104,733	13.00%	2.09	.48 Yr
Total/Calculation	423	\$286,182	\$805,815	100.00%	0.36	2.82 Yr

The preceding table indicates that as of February 27, 2003, 288 of the 423 (68%) commodities on hand at McCarty exceeded a one-year supply; these commodities represent \$701,082 or 87% of the total value of the McCarty inventory.

Concerned by the results of the above analysis, we expanded our work to determine whether slow moving inventory conditions exist at other PWE warehouses. The results of that analysis for the twelve months ending April 17, 2003 are as follows:

PUBLIC WORKS WAREHOUSE	12-MONTH USAGE IN \$	VALUE ON-HAND 4-17-2003	ON-HAND %	INVENTORY TURNOVER	SUPPLY ON-HAND IN YRS
(03) Traffic & Trans.	1,044,828	5,793,875	56.87%	0.18	5.5
(07) PW Central	815,291	986,393	9.68%	0.83	1.2
(08) PW NE Quadrant	51,942	77,676	0.76%	0.67	1.5
(09) PW Stm Sew Maint	294,552	800,944	7.86%	0.37	2.7
(11) PW NW Quadrant	28,036	97,362	0.96%	0.29	3.5
(13) PW SE Quadrant	32,335	60,685	0.60%	0.53	1.9
(14) PW Sowden	624,958	776,547	7.62%	0.80	1.2
(16) PW SW Store #2	8,564	123,957	1.22%	0.07	14.5
(20) PW Meter Shop	108,253	575,356	5.65%	0.19	5.3
(39) PW Frwy Lightings	103,069	194,635	1.91%	0.53	1.9
Subtotal/Calculation	3,111,830	9,487,429	93.12%	0.33	3.0
(32) PW Surplus & Salvg	197	204,691	2.01%	0.00	1040.0
(33) PW Inactive Inv.	18,562	495,767	4.87%	0.04	26.7
Subtotal/Calculation	18,759	700,458	6.88%	0.03	37.3
Grand Total/Calculation	3,130,588	10,187,887	100.00%	0.31	3.3

The inventory turnover ratio is a useful management tool to help determine how well inventory is controlled and managed. A low turnover number is an indication of purchasing problems or obsolete inventory. The PWE's overall turnover ratio is .31. The preceding table indicates that as of April 17, 2003, each PWE Advantage 2000 warehouse had in excess of a one-year supply of commodities on hand and an overall average in excess of 3 years.

FINDINGS

As noted in our previous audit, we continue to believe that “the cost of acquiring, warehousing, and managing excessive quantities of inventory is an unnecessary commitment of City resources and exposes the inventory to obsolescence and misappropriation.”

Conditions regarding inventory usage at McCarty have deteriorated since our last audit. The percentage of commodities on hand exceeding a one-year supply increased from 48% to 68%, and now represents 87% of the value of the McCarty inventory. Further, slow moving commodities are a significant issue at all of PWE warehouses.

MMB now has two full time warehouse employees working at McCarty, as compared to one Section employee at the time of our previous audit. Many of the commodities (including slow moving commodities) warehoused at McCarty could be easily obtained through local retailers and suppliers, as needed using P-Cards, thus eliminating the associated warehousing costs and risks.

RECOMMENDATION

It is imperative that MMB meet operational management’s needs by maintaining adequate, but not excessive, levels of inventory. The Department should require operational management to review inventory at each warehouse to determine what commodities to carry in inventory and the quantity to be carried for each commodity in inventory. Whenever practical, operating management should use a just in time approach toward procurement, meaning items are not carried in inventory but are purchased as needed.

For commodities carried in inventory, MMB should monitor inventory stocking levels to ensure it maintains adequate, but not excessive, quantities of inventory. As needed, MMB should apprise operational management of commodities that may need stocking level adjustments. Operating management should then adjust stocking levels as necessary to meet current needs.

SUBSEQUENT EVENT

While conducting an unrelated inventory audit at the Fire Department (subsequent to the last date of our fieldwork but prior to the issuance of this report), Fire Department management brought to our attention that the SPD report (Cumulative Usage By Stock Item – ICS820q) that we used to perform an inventory turnover analysis was not accurate. The SPD was contacted and they confirmed that the ICS820q report was not accurate. Fire Department management suggested and the SPD concurred that the ABC Inventory Control by Warehouse (ICS661) report should be utilized in conjunction with the Warehouses Status Report by Part # (ICS102) report in performing the inventory turnover analysis. Inventory balances should be obtained from the ICS102 report while inventory usage (issuance) information should be obtained from the ICS661 report. The auditors performed an additional inventory turnover analysis of the Northeast Regional Street and Storm Sewer Maintenance Center as of June 30, 2003 based on the two inventory reports mentioned above.

The results of the additional inventory turnover analysis confirmed our original findings and conclusions. Although we noted improvement in the overall inventory turnover rate (.89 as compared to .36), the percentage of commodities with more than a one-year supply on-hand increased to 91% as compared to 87% of ending inventory.

The Controller's Office Audit Division intends to address the issue of the inaccurate SPD report alluded to above in a separate memorandum to the SPD management.

EXHIBIT II

FOLLOW-UP OF PRIOR REPORT FINDINGS & RECOMMENDATIONS

City of Houston
Office of the City Controller
Audit Division

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NORTHEAST REGIONAL STREET AND STORM SEWER MAINTENANCE CENTER
FOLLOW-UP OF THE UNANNOUNCED INVENTORY AUDIT OF MATERIALS, SUPPLIES AND FIXED ASSETS**

I = Implemented
AI = Alternative Implemented

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EXHIBIT II

FINDING	NO.	RECOMMENDATION	ACTION STATUS	WORK PERFORMED/ CURRENT RECOMMENDATION	DEPARTMENT'S RESPONSE/ ACTION TAKEN OR PLANNED
INVENTORY					
Written Policies and Procedures					
The Storm Sewer Section (Section) was not aware of written policies and procedures for its inventory and warehouse operations, and since the Section's warehouse is non-automated, MMB exercises only limited oversight over the Section's inventory and warehousing operations. We found the Section's inventory accounting policies to be inconsistent with the City's accounting policies and the Section's inventory and warehousing procedures are not adequate to ensure effective internal control and inventory management.	1	The Section should seek, and MMB should provide, guidance on inventory and warehousing policy and procedures.	I	Verified MMB automated the 5500 McCarty Warehouse on the Advantage 2000. Thus, MMB's Standard Operating Procedures (SOP) apply to the McCarty Warehouse.	Interviewed MMB management. The Section transferred its warehouse and inventory management responsibilities to MMB in the Fall of 2001. MMB automated the warehouse and brought it online in Advantage 2000. Advantage 2000 now drives inventory valuation. The SOP for automated warehouse sites dated 12/7/00 serves as guidelines to the 5500 McCarty Warehouse as well.
Warehousing and Inventory Training					
During our unannounced inventory count on February 20, 2001, a Senior Storekeeper was performing the Section's warehouse duties, however, for an extended period of time prior to our count, an equipment operator had temporarily performed the storekeeper's duties. Discussions with the Section Manager indicated that the only training warehouse personnel receive is on-the-job training. Unless employees are trained in the City's accounting policies and PW&E's inventory and warehousing procedures, the result will continue to be ineffective internal controls and a poor inventory management system.	2	The Section should provide inventory management and warehouse personnel proper training in the City's accounting policies and PW&E's inventory and warehousing procedures.	PI	Reviewed documentation of the training provided to warehouse personnel. On the basis of issues noted in our new findings contained in Exhibit II, the auditors conclude OJT is not adequate and recommend that the MMB provide formal training in SOP to its warehouse personnel. MMB should document such training. We concur that training in the City's accounting policy is no longer applicable for 5500 McCarty warehouse personnel.	Interviewed MMB management and requested documentation of training provided to warehouse personnel. MMB management indicated that the only training warehouse personnel receive is on-the-job training (OJT). Training in the City's accounting policy is no longer applicable to 5500 McCarty warehouse personnel because Advantage 2000 drives valuation.

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Periodic Inventory Reports					
The monthly reports are unreliable. For January 2001, the Section reported an inventory valued at \$400,526, however our test counts indicated some items were not included in the report. For example, 205 drums of herbicide, valued at \$232,285, were not included. Also, many commodities included in the report were not valued. Not valuing and excluding commodities understates the value of reported inventory.	3	All appropriate inventory commodities should be included and valued in the Section's monthly inventory reports.	I	During the February 3, 2003 unannounced inventory count, the auditors noted that all commodities tested were recorded in Advantage 2000.	Interviewed MMB management. and they indicated all commodities at 5500 McCarty are included in Advantage 2000.
Controls Over Warehousing and Inventory					
Controls over inventory and warehousing operations at the facility are inadequate, ineffective and do not provide reasonable assurance that materials and supplies are recorded and reported accurately. The majority of our test counts, as confirmed by PW&E's Section Chief, did not match the Section's inventory records. Section personnel could not provide explanations for the differences between our test counts and their inventory records, other than not all receipts, issues, and transfers of inventory are documented. Inadequate documentation of receipts, issues and transfers and unexplained differences between inventory records and actual quantities on hand, indicate poor inventory management and possible misappropriation of City's assets.	4	The Section should establish procedures to promptly and accurately record its warehouse receipts, issues and transfers. Differences between inventory records and actual quantities on-hand should be adjusted only after review and approval by appropriate management.	AI	Conducted unannounced inventory count on February 3, 2003 and noted numerous differences between our count and the Advantage 2000 records. See current findings and recommendations "Alteration and Falsification of City Documents" and Inadequate Security Over Inventory" in Exhibit II.	Interviewed MMB management. Subsequent to the auditors' previous report, PW&E transferred responsibility for inventory management at 5500 McCarty from the Section to the MMB. MMB had and still has, Standard Operating Procedures (SOP) that complied with our previous recommendations.

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Inventory Valuation Method					
The inventory valuation method used by the Section is not consistent with the City's accounting policy. The Section uses unit prices from purchase orders rather than average cost to value inventory. Further, many of the commodities were valued at zero cost.	5	The Section should value its inventory in accordance with the City's accounting policy.	I	Verified that all commodities counted have been valued in Advantage 2000 and the valuation method is consistent with the City's accounting policy.	Interviewed MMB management and they indicated 5500 McCarty commodities have been loaded to the Inventory Control Subsystem in Advantage 2000. The system automatically calculates unit prices. MMB loaded each commodity on to the Advantage 2000 using the average unit cost in effect at the time of the initial loading. If MMB did not know the average unit cost of a particular commodity, they used the best available alternative unit cost information.
Inventory Usage					
We analyzed commodities with quantities on hand included in the Section's December 2000 inventory report to see how long it would take the Department to use the inventory on hand. The quantities on hand of 100 of the 210 commodities exceeded a one-year supply. The cost of acquiring, warehousing, and managing excessive quantities of inventory is an unnecessary commitment of City resources and exposes the inventory to obsolescence and misappropriation.	6	We recommend that the Section maintain its inventory at levels that can be consumed within a more reasonable period of time.	PI	Analyzed inventory usage using the Strategic Purchasing Division's Cumulative Usage By Stock Item report (ICS820q). See our current finding and recommendation "Inventory Usage" in Exhibit II.	Interviewed MMB management and they indicated that they have taken over the ordering of commodities for the 5500 McCarty warehouse. They said usage of items over 18 months has increased; order enough for three or four months balance usage by transferring commodities among warehouses.
Internal Review Section					
During the last five years, the Internal Review Section repeatedly reported many of our current findings to Department	7	We recommend that management take corrective actions to address the	I	Reviewed recent audit reports noting the Internal Review Section addressed its reports to the Director of PWE.	Interviewed the Assistant Director of the Internal Review Section, PW&E. PWE realigned the Internal Review

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management, however, only one of these reports was addressed to the Director. The Section reported issues such as lack of policy and procedures, inconsistent inventory valuation methods, slow moving inventory, excessive inventory levels, and exclusion of inventory items from total inventory. The repeated reporting of these issues indicates the issues were not corrected.		issues noted in the Internal Review Section reports. To ensure management acts on future reports promptly, the Internal Review Section should address its reports to the Director and send copies to affected management.			Section, it now reports to the Director's Chief of Staff and now addresses its reports to the Director of PW&E. The head of the Internal Review Section indicated to the auditors that the situation has improved a lot and that management is responsive than they had been in the past.
FIXED ASSETS -VEHICLES					
Barcodes					
Two of the vehicles were received in September 1999 and had City decals (shop number) and barcodes, and state license plates affixed to them. Of the remaining eleven vehicles received during January and February 2000, only two had barcodes affixed and none had 'decals or license plates. Barcodes and shop numbers are used to identify and track fixed assets and make the vehicles less vulnerable to theft.	1	To facilitate identifying and tracking fixed assets, barcodes should be affixed to assets upon receipt.	I	Reviewed a list of plant accounts containing barcodes received from the F & A Fixed Assets Group.	Conducted a meeting with the Finance & Administration's (F & A) Fixed Assets Group. The Finance and Administration's Fixed Assets Group indicated to the auditors that barcodes have been affixed to the eleven vehicles mentioned in the previous report. They also indicated that shop numbers are assigned to new vehicles upon receipt.
Classifications					
Two 5 yd cabs & chassis were classified as 3-4 yd cabs & chassis because Plant Account Numbers did not exist for five yard chassis, and the next best fit was used. Incorrect Plant Account Numbers diminish the integrity of the asset records and can result in assets being depreciated incorrectly, although in this case	2	We recommend that Financial Management Branch establish Plant Account Numbers when necessary to record asset acquisitions.	I	Reviewed a new plant account number, 341 010 011, that has been created to accommodate the two 5 yd cabs and chassis that were misclassified as 3-4 yd cabs & chassis during the previous audit.	Conducted a meeting with the F & A Fixed Assets Group. The misclassification of the two 5 yd cabs as 3-4 yd cabs did not affect the depreciation amount since the misclassified asset's expected life was not affected. The Fixed Assets Group also indicated it reviews fixed assets

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depreciation was not affected since the useful life of the assets is the same.					periodically to ensure proper classifications.
Capitalization and Depreciation					
The Department's Fixed Asset Detail Report and related Capitalization Forms indicated three of the thirteen vehicles that were received on January 27, 2000 were placed in service and depreciated beginning July 1, 1999 (over six months before the date the vehicles were received by the Department). The Financial Management Branch's review process detected the data entry error, however the noted correction was not made. Consequently, depreciation was overstated by approximately \$4,660 and the resulting net asset values were understated by the same amount.	3	Management should establish adequate controls to ensure that corrections to the fixed asset records are made properly and timely.	I	Reviewed copies of Asset Detail Reports for the three dump trucks in question, with the corrected depreciation amounts.	Conducted a meeting with the F & A Fixed Assets Group. The recommendation to correct the dates of placement of service for three vehicles had been implemented. The date of placement on service is now used to depreciate the three vehicles. Currently, the Fixed Assets Group indicated it performs continuous monitoring to ensure fixed assets are depreciated correctly.
Fixed Assets Listing					
PW&E's Fixed Assets Section maintains records of assets owned by the various divisions. A forklift, valued at \$49,945, was received on December 5, 2000, barcoded, but was not recorded in the Department's Fixed Asset System as of February 21, 2001.	4	We recommend that the Department's Fixed Assets Section implement procedures to effectively capture and promptly record in the Fixed Assets Listing, assets that have been assigned barcodes.	I	Reviewed a copy of the Asset Detail Report listing the forklift in question that was provided to the auditors. The auditors also reviewed a database file containing review notes by the F & A Fixed Assets Group showing the data was reviewed before it was exported to the new system.	Conducted a meeting with the F & A Fixed Assets Group. The forklift that was in question during the previous audit has now been posted. However, the fixed asset export program is still being modified. In the mean time, the F & A Fixed Asset Group indicated it performs continuous monitoring to ensure fixed assets data submitted for posting are accurately posted in the new system.

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EXHIBIT III



CITY OF HOUSTON
Public Works and Engineering
Department

Interoffice

Correspondence

To: Judy Gray Johnson
Office of the City Controller

From: Jon C. Vanden Bosch, P.E., Director
Public Works & Engineering Department

Date: June 10, 2003

Subject: **Management Response to Follow-up of the Unannounced Audit of Materials, Supplies and Fixed Assets**

We have completed our response to your Follow-up Review of the Unannounced Audit of Materials, Supplies and Fixed Assets. We appreciate the following recommendations made by your auditors. In the interim, we will make a concerted effort to implement the necessary changes to improve the effectiveness of the internal control system.

ALTERATION AND FALSIFICATION OF CITY DOCUMENTS

Recommendation:

The Department should require authorizers (field supervisors) to void unused lines on the Material Requisition form. The Department also needs to require recipients to obtain the pink copy of the signed Material Requisition form and return it to appropriate operating management.

Response:

Agree. Instructions contained in a memo from Phil Lightfoot dated March 21, 2003, make it mandatory that after the last item entered on the form, the requisitioner write a "Z" extending through the line following the last item to the bottom of the form. Such an entry is designed to eliminate any items from being added to the form without the knowledge of the requisitioner. MMB retains the original and the requisitioner receives the pink copy in accordance with current procedures. These instructions will be incorporated into current policies and procedures at the time of the next revision and communicated with the operating divisions.

Recommendation:

The Department should also require MMB management to record all inventory adjustments by using Request for Inventory Adjustment in accordance with SOP 007.

Response:

Agree. Warehouse personnel are given training in the proper methods for making inventory adjustments in accordance with SOP 007 and 023. The subject will be reemphasized during future training sessions.

Views of Responsible Officials

EXHIBIT III

Recommendation:

We recommend that PWE management discuss with the Mayor's Office the need for development of a written citywide fraud policy, which should include a section on alteration, and falsification of government documents.

Response:

Disagree. The consequences of alteration or falsification of government documents are already addressed in the Department policy on Progressive Discipline 1-22.

Recommendation:

The Department should implement the above recommendations at all PWE warehouses, not just 5500 McCarty. Upon completion of actions, if any, taken by the OIG, PWE management should determine whether further action is required.

Response:

Agree. All of the above recommendations will be incorporated into Department Policy and Procedures governing warehousing/inventory control operations at all locations. Pending the published findings of the referenced OIG investigation, this matter will be dealt with as a separate issue.

INADEQUATE SECURITY OVER INVENTORY

Recommendation:

The Department should require MMB management and operational management to work together and devise a method to meet each other's needs. One solution might be for MMB to secure the inventory and have MMB warehouse personnel on call in the event of an after hours emergency.

Response:

Agree. Effective immediately, after hours procedures currently in place at all automated warehouses will be strictly enforced at 5500 McCarty. MMB will rekey those areas where inventory is stored and reemphasize the existing call out procedure to handle after hour emergencies. In addition, instructions have been given to survey security at all warehouses and to remedy any deficiencies as quickly as possible.

INVENTORY USAGE

Recommendation:

The Department should require operational management to review inventory at each warehouse to determine what commodities to carry in inventory and the quantity to be carried for each commodity in inventory. Whenever practical, operating management should use a just in time approach toward procurement. For commodities carried in inventory, MMB should monitor inventory stocking levels to ensure it maintains adequate, but not excessive, quantities of inventory.

**Views of Responsible
Officials**

EXHIBIT III

Response:

Agree. Although the inventory turnover has improved to 0.71, it is recognized that inactive inventory does exist. MMB will meet with operating management to determine items and associated quantities to be carried inventory. The PCard program has made the just-in-time approach toward procurement possible.

If you have any further questions, please contact Waynette Chan at (713) 837-0249 or Godwin Okoro at (713) 837-0347.



Jon C. Vanden Bosch

JV:ra

cc: Steve Schoonover
Ken Teer
Bob Bowers
Susan Bandy
George Bravenec
Gilbert Garcia
Waynette Chan
Godwin Okoro

**Views of Responsible
Officials**