

I. EXECUTIVE SUMMARY

The Office of Public Integrity (OPI) observed the annual physical inventory of the Bureau of Water on May 21, 2011. This inventory included the Water stockroom, the Street Lighting stockroom and the Department of Recreation and Youth Services (DRYS), Bureau of Recreation inventory, maintained by the Bureau of Water. The results of the inventory indicate that the Bureau of Water maintains adequate inventory control.

- ◆ OPI noted variances in 1.1% of our sample selection of water stockroom inventory indicative of the differences between the physical counts and the quantities recorded in the perpetual records. This is slightly lower than the 1.2% error rate noted in the previous inventory.
- ◆ OPI noted variances in .5% of street lighting stockroom inventory items indicative of differences between the physical counts and the quantities recorded in the perpetual records. This is slightly lower than the .7% error rate noted in the previous inventory.
- ◆ OPI did not note any variances in our sample selection of DRYS, Bureau of Recreation inventory items. We noted a 1.8% variance in the previous inventory.

II. BACKGROUND, OBJECTIVES, AND SCOPE

A. Assignment

The Office of Public Integrity routinely observes and participates in annual physical inventories of various City stockrooms to independently ensure the accuracy of the inventory counts and to evaluate internal controls in the inventory maintenance process. The Bureau of Water conducted its annual physical inventory of the Water, Street Lighting, and DRYS, Bureau of Recreation stockrooms on May 21, 2011. OPI participated in these counts at the request of the Department of Environmental Services.

B. Background

The Materials and Equipment unit of the Director's Office stores and manages an inventory of supplies and materials necessary to operate and maintain the water distribution system. As of May 21, 2011, the inventory consisted of 2,357 line items valued at \$1,602,001. In addition to the main inventory storage area on Felix Street, the Bureau of Water also stores some inventory at the Hemlock Lake treatment facilities. Accordingly, OPI also verified the inventory at that location. As of May 21, 2011, the inventory at Hemlock Lake consisted of 59 line items valued at \$238,247, for a combined inventory totaling 2,416 items valued at \$1,840,248.

In 2007, City management transferred the Street Lighting unit from the Bureau of Water to the Bureau of Architecture and Engineering. However, the Materials and Equipment unit of the Bureau of Water continues to store and manage the street lighting inventory of supplies and materials. The Street Lighting unit oversees the City's street lighting system. As of May 21, 2011, the inventory consisted of 383 line items valued at \$763,172.

In June 2008, City management transferred the DRYs, Bureau of Recreation stockroom to the Materials and Equipment unit of the Bureau of Water. As of May 21, 2011, this inventory consisted of 1,905 line items valued at \$315,036.

Bureau of Water stockroom personnel utilize an automated inventory system that assists in controlling quantities and providing various management information. A perpetual inventory record is an essential feature of this system.

C. Objective and Scope

The objectives of this review are to assure an accurate and complete physical inventory count and to assess the effectiveness of inventory controls.

Management is responsible for establishing and maintaining a system of internal accounting and administrative control. Fulfilling this responsibility requires estimates and judgments by management to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of accurate, informative reports that are fairly stated.

Because of inherent limitations in any system of internal accounting and administrative control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any system evaluation to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

The recommendations presented in this report include the more significant areas of potential improvement that came to our attention during the course of the examination, but do not include all possible improvements that a more extensive review might develop.

III. RESULTS OF REVIEW

The results of this physical inventory indicate the variance rates for the Water stockroom, Street Lighting stockroom, and DRYS, Bureau of Recreation stockroom have all decreased since the last inventory date.

A. Variance Analysis - Water Stockroom

The Office of Public Integrity selected a statistical sample of items included in the stockroom inventory. The sample selection assures proper representation throughout the entire population of inventory items and allows us to accurately project the results against the entire inventory. The range of unit costs included in the sample extends from \$0.05 to \$5,277.30. OPI compared the actual count of each of these selected items to perpetual records and noted any variances.

Of the 175 inventory items tested in the sample, variances exist in two items. This represents a sample error rate of 1.1%. The following graph presents historical error rates as a reference.

**Bureau of Water
Water Stockroom Inventory
Sample Error Rate Percentages**

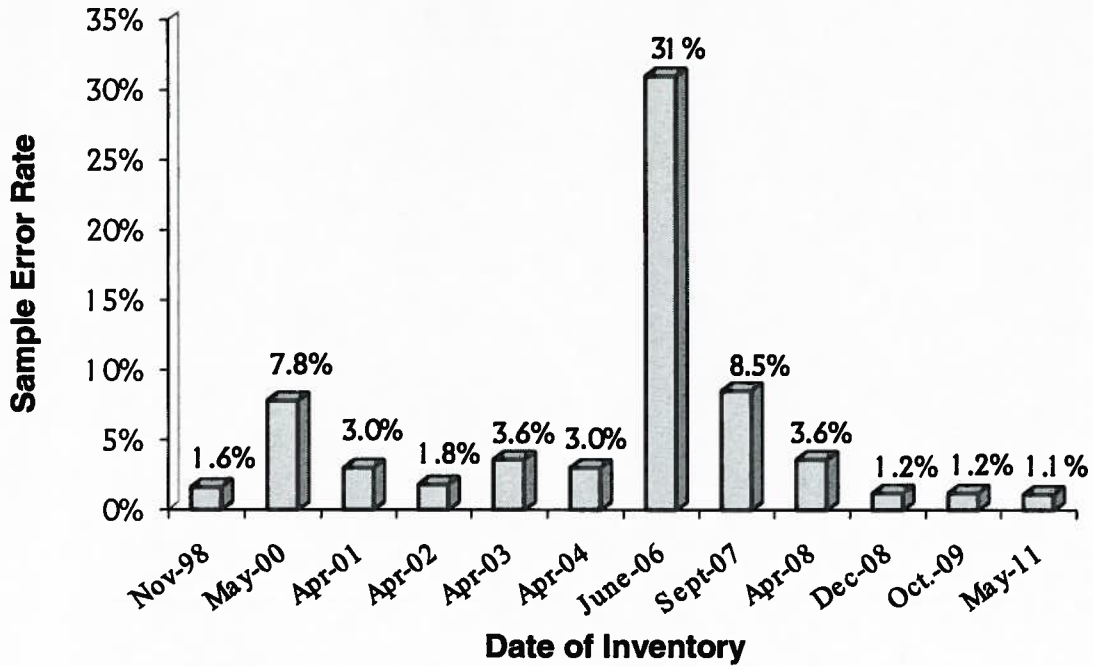


Table I (attached) presents the variance analysis of the statistical sample selection for those items in which a variance exists. It demonstrates individual variances between actual physical counts and quantities recorded in the perpetual records, and presents positive and negative variances separately. Additionally, the table includes the net variance. To eliminate counting errors, Bureau personnel recounted all items in which a difference existed between the quantities recorded in the perpetual record and the actual quantities on hand during the physical inventory.

When OPI extends the sample error rate of 1.1% to the entire population of 2,416 different stock items, the projection indicates that the actual number of errors in the population is in the range of 5 and 85 stock items. When comparing the current error rate of 1.1% to the prior error rates of 1.2% in 2009 and 1.2% in 2008, it appears that, based on the results of the sample selection, Bureau of Water personnel have continued to maintain adequate control over the stockroom inventory. Additionally, it appears that the implementation of cycle counts throughout the year has assisted in achieving and maintaining these lower variance rates.

◆ Recommendation

Bureau management should continue to make inventory control a priority.

B. Variance Analysis - Street Lighting Stockroom

Due to the relatively small number of street lighting inventory line items, OPI examined 100% of the inventory rather than selecting a statistical sample. As a result, the error rate noted represents the true error rate in the entire population of street lighting inventory items. The range of unit costs included in the inventory extends from \$0.00 to \$6,817.34. The Office of Public Integrity compared the actual count of each of these items to perpetual records and noted any variances. Of the 383 line items in the street lighting inventory, variances exist in two items. The true error rate is .5%. This variance is slightly lower than the .7% error rate we noted in October 2009 and significantly lower than the variance rate of 6.8% we noted in December 2008. This variance represents the implementation of corrective actions by Water personnel when compared to both the variance rate of 21% noted in September 2007 and the error rate of 20% that we noted in the 2006 inventory. The following graph presents historical error rates as a reference.

Bureau of Water
Street Lighting Stockroom Inventory
Inventory Variance Error Rate Percentages

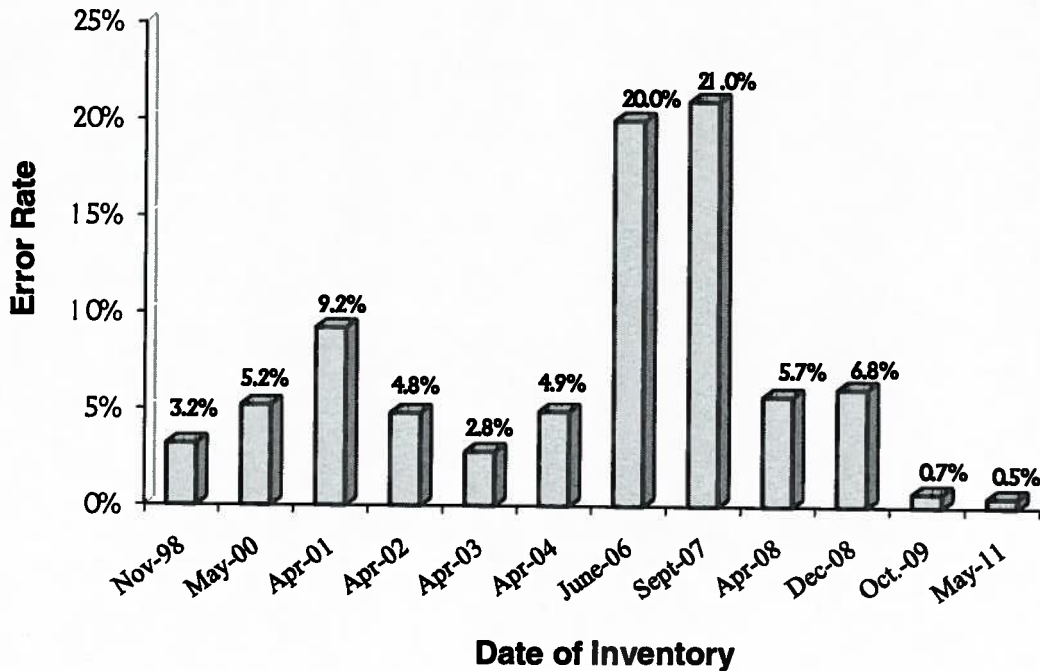


Table II (attached) presents the variance analysis for those items in which a variance exists. It demonstrates individual variances between actual physical counts and quantities recorded in the perpetual records, and presents positive and negative variances separately. Additionally, the table includes the net variance. To eliminate counting errors, Bureau of Water personnel recounted all items in which a difference existed between the quantities recorded in the perpetual record and the actual quantities on hand during the physical inventory.

◆ Recommendation

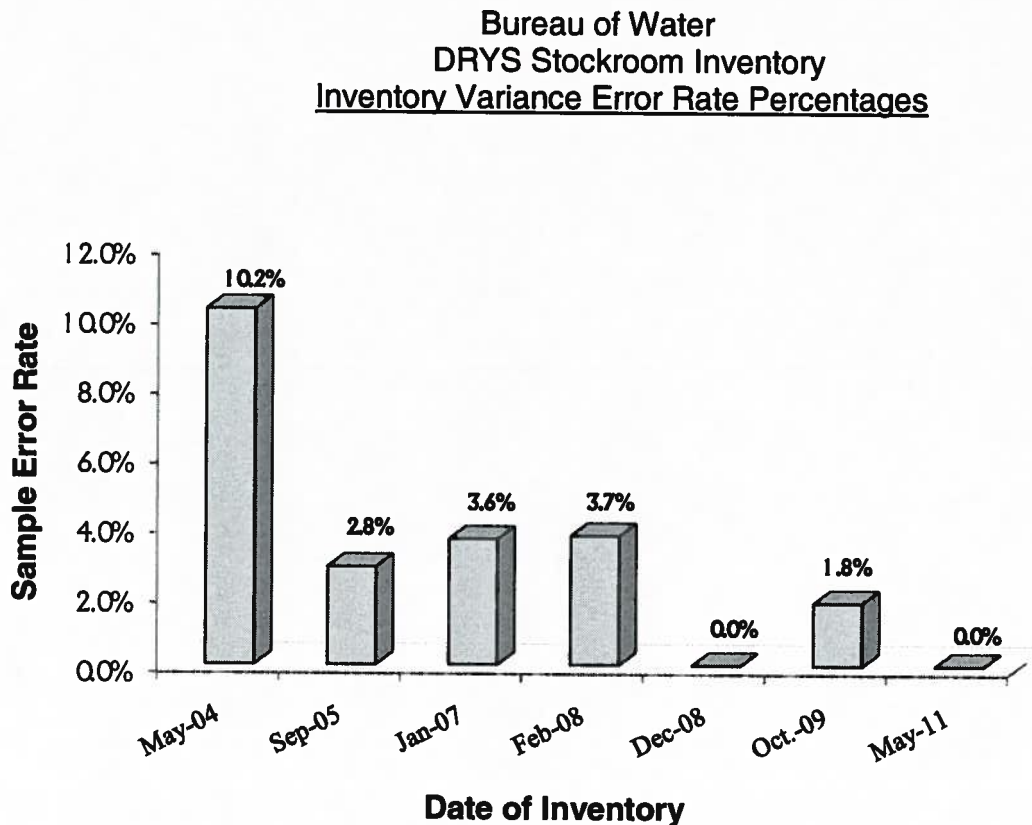
Bureau management should continue to make inventory control a priority.

C. Variance Analysis – DRYS Stockroom

The Office of Public Integrity selected a statistical sample of items included in the DRYS stockroom inventory maintained by the Bureau of Water. The sample selection assures proper representation throughout the entire population of inventory items and allows us to accurately project

the results against the entire inventory. The range of unit costs included in the sample extends from \$0.09 to \$3,165.00. OPI compared the actual count of each of these selected items to perpetual records and noted any variances.

Of the 172 line items selected, OPI did not note any variances. The sample error rate is therefore 0%. The following graph presents historical error rates as a reference.



When OPI extends the sample error rate of 0% to the entire population of 1,905 different stock items, the projection indicates that the actual number of errors in the population is in the range of 0 and 41 stock items. When comparing the current error rate of 0% to the prior error rates of 1.8% in 2009 and 0% in 2008, it appears that, based on the results of the sample selection, Bureau of Water personnel have continued to maintain adequate control over the stockroom inventory.

♦ Recommendation

Bureau management should continue to make inventory control a priority.

IV. DEPARTMENTAL RESPONSE

The response of the Department of Environmental Services follows.

**TABLE I: Department of Environmental Services
Bureau of Water
Water Stock Room Inventory – May 21, 2011
Schedule of Inventory Variances Only**

Stock Number	Part Description	Booked Quantity On Hand	Actual Quantity Counted	Item Count Variance		Unit Cost	Dollar Variance	
				Over	Short		Over	Short
60202	Mtr 2" rr	59	57		2	\$398.00		
0013	Reducer 12X* MJxMJ	<u>3</u>	<u>4</u>	<u>1</u>		168.56	<u>\$168.56</u>	
		<u>62</u>	<u>61</u>	<u>1</u>	<u>2</u>		<u>\$168.56</u>	<u>-\$796.00</u>
Net Variance								<u>-\$627.44</u>

TABLE II: Department of Environmental Services
Bureau of Water
Street Lighting Stock Room Inventory – May 21, 2011
Schedule of Inventory Variances Only

<u>Stock Number</u>	<u>Part Description</u>	<u>Booked Quantity On Hand</u>	<u>Actual Quantity Counted</u>	<u>Item Count Variance</u>		<u>Unit Cost</u>	<u>Dollar Variance</u>	
				<u>Over</u>	<u>Short</u>		<u>Over</u>	<u>Short</u>
5L002	Anchor bolt set 5/8"4	248	240		8	\$ 2.50		-\$ 20.00
5L101	Pole 30' gal sing. davit-used	<u>1</u>	<u>2</u>	<u>1</u>	<u>-</u>	600.00	<u>\$600.00</u>	
		<u>249</u>	<u>242</u>	<u>1</u>	<u>8</u>		<u>\$600.00</u>	<u>-\$ 20.00</u>
Net Variance								<u>\$580.00</u>



RECEIVED

JUL 28 2011

CITY OF ROCHESTER
OFFICE OF PUBLIC INTEGRITY

To: Daniel Mastrella, Internal Audit/OPI

RM From: Paul Holahan, Commissioner/DES P.H.

Date: July 19, 2011

Subject: Inventory Audit Results – Water, St. Lighting and DRYS

The Water Bureau conducted its physical inventories of the Water Materials, St. Lighting and DRYS stockrooms on May 21, 2011. The last inventory of these areas was performed October 10, 2009. The Office of Public Integrity observed these inventories.

At the time of the most recent audit, the Materials & Equipment stockroom maintained more than 4700 items, comprised of 173,828 physically counted units valued at \$2,918,456.

The OPI results, based on sample selection, indicate a variance rate of 1.1% for Water Materials and a variance rate of 0.0% for DRYS. The Street Lighting variance rate, based on a 100% audit, was found to be .5%. I am pleased to find all three inventory variances were lower than the variances found during the previous audit. In fact, without exception, all three inventory results are the best recorded rates at least as far back as 1998.

After reviewing comparing overall numbers from 10/09 to 05/11, we are pleased to find that, based on 100% audit of all three databases, the combined accumulated variances by item to be 0.5%.

I am confident that the Materials & Equipment staff will continue to make inventory control a top priority. Please contact me as needed.

Attachments: 10/10/09 findings
05/21/11 findings

XC: R. Morrison
M. Ekiert