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INTERNAL AUDIT DEPARTMENT

Audit of the
Annual Physical Inventory

Fiscal Year 2018

September 2018

Performance Audit

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EXECUTIVE SUMMARY

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2018 Annual Physical Inventory (Inventory). The Inventory is coordinated by Purchasing and Materials Management Department personnel. Its purpose is to ensure that the on-hand quantity for each inventory item is accurately recorded in the PeopleSoft financial system so that transit operations are supported by having materials and supplies available when needed. This Inventory was performed from March 2, 2018 to March 4, 2018. For FY 2018, material and supply expenditures were approximately $18.8 million or 4.3% of total expenses of $432 million (per the audited financial statements as of June 30, 2017).

OBJECTIVES, SCOPE AND METHODOLOGY

The audit objectives were to determine the adequacy of internal controls for the Inventory and to determine if items were accurately counted, variances and adjustments were recorded correctly in PeopleSoft, and the cut-off process was properly followed for requisitions and receivers issued before and after Inventory. The scope of the audit was the FY 2018 Inventory.

We observed the employees as they counted the inventory items, and we independently tested a sample of the inventory counts, the accuracy of the inventory cut-off process and assisted in resolving variances.

STATEMENT OF OPINION

In our opinion, in general, the FY 2018 Inventory was conducted in a manner that provides reasonable assurance that inventory items were accurately counted, adjustments to on-hand quantities were recorded correctly in PeopleSoft, the cut-off process was properly followed for requisitions and receivers issued before and after Inventory and significant variances were resolved and recorded correctly in PeopleSoft. We made recommendations to improve internal controls and business processes going forward as summarized in this report.

STRENGTHS NOTED DURING THE AUDIT

Strengths noted during the audit included the following:

1) At Manchester inventory location, overflow stock notices were effectively used and typically placed for items with overflow stock at both the default bin location and the excess inventory location and were helpful in identifying items with overflow stock.

2) At Manchester inventory location, the Stores Requisition – Return to Stock form (the paperwork associated with inventory items being returned to the Manchester storeroom) appear to be properly completed/processed and the on-hand quantity in PeopleSoft appeared to be properly increased when the items were returned.

3) Prior to the start of Inventory, the Manager, Purchasing Materials worked with the Manager of Inventory Operations and Distribution who coordinated with applicable supervisory personnel at the locations to identify items with more than one bin location and to review

and adequately resolve the items prior to the start of the FY 2018 Annual Physical Inventory.

RESULTS OF TEST

Based on our statistically valid sample and a margin of error of plus or minus 4%, we are 95% confident that the true accuracy rate of item counts in the population is between 88.9% and 96.9%.

OBSERVATIONS AND RECOMMENDATION

OBSERVATION 1 – INVENTORY CUT-OFF PRACTICES REQUIRE IMPROVEMENT

The last five (5) requisitions and receivers before inventory and the first five (5) requisitions and receivers after inventory were reviewed for Manchester, South Hills Junction and South Hills Village. Of the 60 requisitions and receivers reviewed as part of the inventory cut-off testing, 55 (or 92%) were processed according to the cut-off instructions. The 5 exceptions noted were related to items at the Manchester location that were physically added to the shelves before inventory but were not processed and putaway in PeopleSoft until after the inventory.

As a result of Manchester's cut-off testing exceptions, Internal Audit Department personnel reviewed receivers (before the inventory cut-off as of 3/1/2018) and determined the put-away process was not completed at Manchester in PeopleSoft for 33 (with a total value of $42,443.49) items that had been received into inventory.

As a result of the putaway process not being completed for these items, the value of the inventory items and the on-hand quantities were recorded incorrectly in PeopleSoft. Internal Audit Department personnel informed storeroom supervisory personnel at Manchester of the exceptions, and the appropriate adjustments were made to ensure the inventory quantities in PeopleSoft agreed with the quantities of inventory on-hand in the storeroom.

Business Impact

Failure to follow inventory cut-off instructions increases the risk that the value of inventory may be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 1

Internal Audit Department personnel are cognizant of the fact that PAAC is potentially transitioning to a new Maintenance Work Order System (MWOS) to be utilized for daily operations (to include inventory) that will affect the manner in which PAAC's Annual Physical Inventory is performed.

In the event that PAAC continues to perform Annual Physical Inventory in the same manner as previous years, going forward we recommend the following:

1) Before shutting down the business units for Inventory, supervisory personnel at Manchester should verify that all items that are physically received at the dock are placed on the shelf and the put away process is completed in PeopleSoft.

2) The Manager of Inventory Operations and Distribution and supervisory personnel should run the INP 6600 Receiving Report or PAG_RECEIPTS Query in PeopleSoft to determine if there are any items that appear on this report that have been received after the designated cut-off date and, if so, complete the putaway process in PeopleSoft for these items. Storeroom and supervisory personnel should then inform the Manager, Purchasing Materials that the putaway process has been completed for all items that have been physically received and placed into inventory.

3) The Manager, Purchasing Materials should verify with the Manchester 2nd shift supervisor that the putaway process is complete and confirm by reviewing the PAG_RECEIPTS Query in PeopleSoft.

4) All items received at the dock at Manchester (after inventory shutdown) should be held at the dock until after the physical inventory when normal business activity resumes and, at which time, these items should be placed on the shelf and the putaway process completed in PeopleSoft.

MANAGEMENT RESPONSE 1

Management concurs with the recommendation.

Target date for Implementation: FY 2019 Annual Physical Inventory

OBSERVATION 2 – EMERGENCY REQUISITION PROCESS CAN BE IMPROVED

Internal Audit Department personnel noted that the process for handling of emergency items at Manchester was not properly handled during the FY 2018 Annual Physical Inventory count as recommended in previous years. There were a total of 29 Emergency Requisition items at Manchester that Internal Audit Department personnel reviewed (100%). All 29 items were not properly processed because either the:

1) Inventory count was not recorded correctly in PeopleSoft for the Emergency Requisition items issued before the items were initially counted, and/or

2) Items were not depleted in PeopleSoft documenting the fulfillment of the requisition.

As a result of not properly handling the processing of the Emergency Requisitions, the value of the inventory items and the on-hand quantities were recorded incorrectly in PeopleSoft. As a result of this audit, storeroom supervisory personnel at Manchester were made aware of the exceptions, and the appropriate adjustments were made to ensure the inventory quantities in PeopleSoft agreed with the quantities of inventory on-hand in the storeroom.

Business Impact

Failure to properly follow the process for handling Emergency Requisitions increases the risk that the value of inventory may be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 2

Internal Audit Department personnel are cognizant of the fact that PAAC is potentially transitioning to a new Maintenance Work Order System (MWOS) to be utilized for daily operations (to include inventory) that will affect the manner in which PAAC's Annual Physical Inventory is performed.

In the event that PAAC continues to perform Annual Physical Inventory in the same manner as previous years, the process used for handling Emergency Requisitions at Manchester can be improved before and during the inventory; and, going forward, we recommend the following at Manchester:

1) The Manager of Inventory Operations & Distribution should review the Emergency Requisition process with the assigned storeroom and supervisory personnel (on each shift and during inventory) who will be responsible for controlling and documenting emergency requisitions.

2) The Manager, Purchasing Materials and Manager of Inventory Operations & Distribution should ensure that:

    a) Counts for Emergency Requisition items are accurately entered in PeopleSoft, and

    b) Where necessary, the depletion process is completed in PeopleSoft for the same items on the final day of the Annual Physical Inventory.

3) The Manager, Purchasing Materials and Manager of Inventory Operations & Distribution should inform Internal Audit Department personnel, when they have completed the Emergency Requisition process of accurately entering the item count and, where necessary, complete the depletion process in PeopleSoft on the final day of the Annual Physical Inventory.

MANAGEMENT RESPONSE 2

Management concurs with the recommendation.

Target date for Implementation: FY 2019 Annual Physical Inventory

OBSERVATION 3 – INACTIVE ITEMS INCLUDED IN THE INVENTORY

At the time of Inventory, we observed that there were a total of 203 inactive stock items listed on the Shut-Down queries/reports provided by the Manager, Purchasing Materials. These inactive stock items had an average unit cost of $2.00 or greater. The items listed on the Shut-Down queries/reports were compared to the Inventory Count Sheets and it was determined that 196 out of 203 inactive items were counted during the FY 2018 Annual Physical Inventory.

Previously, management stated that inactive items should not be included in inventory and these stock items should either be active, because they still have a potential use at Port Authority, or inactive because they have been scrapped.

Business Impact

If inactive items that are scrapped remain in inventory, adequate space may not be available to store new and existing inventory items and additional time may be required to complete the Inventory as the result of counting items that may no longer have use at Port Authority.

RECOMMENDATION 3

In order to potentially free up space in the storerooms for new and existing inventory items and ensure that items that should be scrapped are properly resolved, Purchasing and Materials Management personnel should:

1) Work with appropriate storeroom and supervisory personnel to revise and document (in writing) the inventory scrap process for Port Authority's inactive and obsolete inventory items.

This process should consider (but is not limited to) the following:

a) Identifying, limiting and controlling the number of personnel authorized to change the status of an inventory item (active and inactive) and complete the scrap process.

b) Defining an "inactive" inventory item at the business unit and item level.

c) Informing and instructing appropriate personnel, responsible for changing the status of an inventory item to active/inactive and completing the scrap process, of the revised process to ensure they are aware of the procedure.

d) Monitoring the scrap process for inactive items that have been determined to be obsolete and ensuring these items have been carried through the complete scrap process (the items are actually scrapped, the bin tag is removed, and the item is moved to the "none" bin in PeopleSoft).

e) Determining the frequency of running a query to verify that the scrap process has been completed for the inactive/obsolete inventory item.

2) Once this revised scrap process has been developed, identify all inactive items that are currently included in Inventory. These items should be reviewed and:

a) Should either be activated and maintained in Inventory, if they can still be used as part of Port Authority business operations, or be removed from Inventory and taken through the entire scrap process, if they are obsolete and not being used, and

b) Management should verify that the scrap process for these inactive items that have been determined to be obsolete has been carried through to completion and Internal Audit Department personnel should be notified once the scrap process for these items has been completed.

MANAGEMENT RESPONSE 3

Management concurred with the recommendation and item 1 has been implemented. In addition, item 2 will be implemented before FY2019 Annual Physical Inventory.

ADVISORY COMMENT 1 – MARKING ITEMS WITH OVERFLOW STOCK AT SOUTH HILLS JUNCTION

We noted multiple instances at South Hills Junction where items with overflow stock were not marked. As a result, additional time was needed by the inventory count crews and by Internal Audit Department personnel to verify/confirm and count some of the inventory items. In addition, if overflow stock is not adequately marked, Stockroom personnel unfamiliar with the location may have difficulty locating items and may order items when there is already an adequate quantity on-hand.

RECOMMENDATION

All bins with overflow stock should be clearly marked and the overflow stock itself should be clearly marked.

MANAGEMENT RESPONSE

Management concurs with this recommendation and it is Purchasing and Materials Management personnel's goal to ensure the use of overflow signs in all stockrooms.

ADVISORY COMMENT 2 – IMPROVING INTERNAL CONTROLS FOR PARTS ROOMS

We observed the following:

1) Currently PAAC's parts rooms/cages where Inventory parts are located at seven (7) locations (that are included in the Inventory) are not equipped with cameras.

2) Parts rooms are not staffed with a receiver (who is responsible for recording inventory transactions in the storeroom) at all times during maintenance hours.

    - Specifically, no parts rooms are staffed during weekend maintenance hours (during any shift) or on the third shift at most parts rooms locations.

    - The practice of not staffing parts rooms with receivers during specific periods was a management decision to attempt to control costs. Previously, management stated that they have attempted to mitigate the associated risks by securely storing some items in protected/locked areas.

PAAC also has an Auto Shop located at South Hills Junctions where non-revenue vehicles are serviced. Items/parts are purchased on an as needed basis utilizing Purchase Orders (PO) and not recorded as inventory in PeopleSoft but rather are expensed as they are purchased.

The FY2018 Auto Shop purchase orders (7/5/17 – 6/28/18) totaled approximately $390,313.45.

The Auto Shop parts rooms/cages are not equipped with cameras, staffed with a receiver, or locked at all times. Parts are accessible to all personnel from 7:00 am to 12:00 am Monday through Friday and

the rooms are locked at all other times. However, management stated batteries are controlled in a secured/locked area.

Business Impact

Although the practice of not staffing the parts rooms full-time may be cost effective, it may make managing materials from receipt to requisition and identifying reasons for inventory shortages more difficult. This may result in inaccurate quantities in PeopleSoft and inaccurately reflect the cost of vehicle maintenance.

However, in performing the annual inventory audits and throughout the audit process, Internal Audit Department personnel assess risks that are significant within the audit objectives. If risks are identified, procedures may be designed to obtain reasonable assurance of detecting any significant matters. In addition, Purchasing and Materials Management personnel stated that they utilize variance reports/reconciliation reports to analyze variances in an effort to determine, control and correct the discrepancies.

RECOMMENDATION

To assist with managing and controlling inventory and identifying reasons for inventory shortages, more accurately reflect the cost of vehicle maintenance and to mitigate risk to an acceptable level, we recommend that management should determine the most effective approach to tracking the receipt and requisition of parts and review the cost effectiveness of the following:

- Installing cameras where all parts/supplies are located to assist in securing parts and supplies and the visual confirmation of receipt/requisition (tracking) of parts and access to parts by personnel, and

- Receiver staffing levels and hours to determine if the parts rooms are staffed to a sufficient level during all maintenance hours and/or if additional receivers are needed.

MANAGEMENT RESPONSE

Purchasing and Materials Management personnel stated that they will investigate/review the cost effectiveness of:

- Installing cameras where all parts/supplies are located, and

- Receiver staffing levels/hours to determine if parts rooms are staffed to sufficient levels during maintenance hours and/or if additional receivers are needed.

Target date for Implementation: Review during the 2020 budget process.

FOLLOW UP ON OUTSTANDING AUDIT RECOMMENDATIONS FROM PREVIOUS AUDITS

The recommendations made during previous audits are closed.

INTRODUCTION

Port Authority internal auditors observed the fiscal year (FY) 2018 Annual Physical Inventory (Inventory). The Inventory is coordinated by Purchasing and Materials Management Department personnel. Its purpose is to ensure that the on-hand quantity for each inventory item is accurately recorded in the PeopleSoft financial system so that transit operations are supported by having materials and supplies available when needed. This Inventory was performed from March 2, 2018 to March 4, 2018. For FY 2018, material and supply expenditures were approximately $18.8 million or 4.3% of total expenses of $432 million (per the audited financial statements as of June 30, 2017).

OBJECTIVES, SCOPE AND METHODOLOGY

The audit objectives were to determine the adequacy of internal controls for the Inventory and to determine if:

- Inventory items were accurately counted,
- Dollar variances of at least $250.00 ($150.00 at the garage inventory locations) and a quantity variance of at least 10 percent were resolved and recorded correctly in PeopleSoft,
- Adjustments to on-hand quantities were properly recorded in PeopleSoft, and
- The cut-off process was properly followed for requisitions and receivers issued before and after Inventory. The cut-off is the time at which system processing of receivers and requisitions is suspended in PeopleSoft. The purpose of the cut-off testing is to determine if:
    - Items that were physically received and placed in stock prior to the start of counting were included in PeopleSoft's on-hand quantities,
    - Items that were physically received and not placed in stock prior to the start of counting were not included in PeopleSoft's on-hand quantities,
    - Requisitions that were filled and shipped prior to the start of counting were processed in PeopleSoft so that the on-hand quantities in the system are reduced prior to counting,
    - Items removed from stock after counting has begun (Emergency Requisitions) are added to the physical count if the item was removed from stock before it was counted,
    - Items physically received while the Inventory is in progress are held at the receiving dock instead of being placed in Inventory, and

- Employees do not resume filling requisitions, stocking items and processing requisitions and receivers in PeopleSoft until after the Inventory is finalized and the cut-off is ended.

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.

We observed the employees as they counted the inventory items and tested inventory counts and the cut-off process at the Manchester, South Hills Village and South Hills Junction locations. We tested the accuracy of the inventory cut-off process by tracing a sample of requisitions and receivers to the Review Transaction History panel in PeopleSoft to ensure that they were processed in PeopleSoft at the correct time in relation to the cut-off. We also assisted in resolving variances. In addition, at these three locations and at the Collier and East Liberty garage locations, we tested the accuracy of on-hand quantities recorded by the employees conducting the Inventory by independently counting a sample of inventory items and comparing our counts with the counts on the count sheets.

STATEMENT OF OPINION

In our opinion, in general, the FY 2018 Inventory was conducted in a manner that provides reasonable assurance that inventory items were accurately counted, adjustments to on-hand quantities were recorded correctly in PeopleSoft, the cut-off process was properly followed for requisitions and receivers issued before and after Inventory and significant variances were resolved and recorded correctly in PeopleSoft. We made recommendations to improve internal controls and business processes going forward as summarized in this report.

STRENGTHS NOTED DURING THE AUDIT

Strengths noted during the audit included the following:

1) At Manchester inventory location, overflow stock notices were effectively used and typically placed for items with overflow stock at both the default bin location and the excess inventory location and were helpful in identifying items with overflow stock.

2) At Manchester inventory location, the Stores Requisition – The Return to Stock forms (the paperwork associated with inventory items being returned to the Manchester storeroom) that were tested appeared to be properly completed/processed and the on-hand quantity in PeopleSoft appeared to be properly increased when the items were returned.

3) Prior to the start of Inventory, the Manager, Purchasing Materials worked with the Manager of Inventory Operations and Distribution who coordinated with applicable supervisory personnel at the locations to identify items with more than one bin location

and to review and adequately resolve the items prior to the start of the FY 2018 Annual Physical Inventory.

RESULTS OF TEST COUNTS

Based on our statistically valid sample and a margin of error of plus or minus 4%, we are 95% confident that the true accuracy rate of item counts in the population is between 88.9% and 96.9%.

Using attribute sampling for a population size of 12,940 items with an average cost of at least $2.00, a statistically valid sample of 157 items was selected for testing. Internal Audit Department personnel counted each item in the sample and compared our count to the count recorded on the count sheets. Any discrepancies were resolved by having storeroom personnel recount item count discrepancies. We noted 11 errors and 146 items counted correctly by the inventory count crew (an overall accuracy rate of 93%).

Summary of Systematically Selected Test Counts

Location	Number of Items with an Average Cost of at Least $2	Number of Test Counts	Number of Count Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	9,213	107	9	98	92%
South Hills Junction	1,772	21	0	21	100%
South Hills Village	1,955	29	2	27	93%
Totals	**12,940**	**157**	**11**	**146**	**93%**

Of these 157 test counts, 141 items had a unit of measure of "each" and 16 items had a unit of measure of something other than "each" such as "case," "set," "foot," "kit," "roll," or "spool," etc.

We determined that 146 items with a unit of measure of each and other than each were counted correctly and 11 items were incorrectly counted by the inventory count crews (an accuracy rate of 93%). For the 141 items with a unit of measure of "each," 132 items were counted correctly and 9 items were incorrectly counted by the inventory count crew (an accuracy rate of 94%). For the 16 items with a unit of measure of other than "each" such as "case," "set," "foot," "kit," "roll," or "spool," etc., 14 items were counted correctly and 2 items were incorrectly counted by the inventory count crew (an accuracy rate of 88%).

Summary of Judgmentally Selected Test Counts

Location	Number of Test Counts	Number of Count Discrepancies	Number of Accurate Counts	Percentage of Accurate Counts
Manchester	105	7	98	93%
South Hills Junction	54	6	48	89%
South Hills Village	52	4	48	92 %
Collier	51	0	51	100%
East Liberty	52	1	51	98%
Totals	**314**	**18**	**296**	**94%**

In addition to the systematically selected test counts from our sample, we judgmentally selected and counted 314 Inventory items, 278 items had a unit of measure of "each" and 36 items contained a unit of measure of something "other than each," such as "case," "set," "foot," "kit," "roll," or "spool," etc.

We determined that 296 items with a unit of measure of each and other than each were counted correctly and 18 items were incorrectly counted by the inventory count crews (an accuracy rate of 94%). For the 278 items with a unit of measure of "each," 264 items were counted correctly and 14 items were incorrectly counted by the inventory count crew (an accuracy rate of 95%). For the 36 items with a unit of measure of "other than each," 32 items were counted correctly and 4 items were incorrectly counted by the inventory count crew (an accuracy rate of 89%).

Note that the accuracy rates discussed above estimate the accuracy of the counts that are made by the inventory count crews. This accuracy rate should not be compared with the Purchasing and Materials Management Department's estimate of the accuracy rate at which the on-hand quantities of inventory items are maintained in PeopleSoft's records.[1]

[1] Purchasing and Materials Management Department staff calculates their accuracy rate, which is reported on the Recap of Inventory Results – FY 2018 Inventory Accuracy report, for items with an average cost of at least $2.00 by dividing the number of items with no variances and the number of items with minor variances as determined by the Purchasing and Materials Management Department staff, by the total number of items with an average cost of at least $2.00. The Purchasing and Materials Management Department staff defines a minor variance for the Manchester, South Hills Village and South Hills Junction warehouses locations as one that is less than $250.00 in value and 10% in quantity. For the garage locations, a minor variance is defined as one that is less than $150.00 in value and 10% in quantity.

OBSERVATIONS AND RECOMMENDATIONS

OBSERVATION 1 – INVENTORY CUT-OFF PRACTICES REQUIRE IMPROVEMENT

The last five (5) requisitions and receivers before inventory and the first five (5) requisitions and receivers after inventory were reviewed for Manchester, South Hills Junction and South Hills Village. Of the 60 requisitions and receivers reviewed as part of the inventory cut-off testing, 55 (or 92%) were processed according to the cut-off instructions. The 5 exceptions noted were related to items at the Manchester location that were physically added to the shelves before inventory but were not processed and putaway in PeopleSoft until after the inventory.

As a result of Manchester's cut-off testing exceptions, Internal Audit Department personnel reviewed receivers (before the inventory cut-off as of 3/1/2018) and determined the put-away process was not completed at Manchester in PeopleSoft for 33 items that had been received into inventory, which is as follows:

Thirty-three (33) stock items* with a total value of $42,443.49* were received at Manchester prior to the Inventory and, as stated by Manchester personnel, were placed in their assigned inventory locations prior to the Inventory. However, these stock items were not entered as being received and put-away in PeopleSoft (which updates on-hand quantities) until March 26, 2018 after the Inventory. As a result of the putaway process not being completed for these items, the value of the inventory items and the on-hand quantities were recorded incorrectly in PeopleSoft. As a result of this audit, storeroom supervisory personnel at Manchester were made aware of the exceptions, and the appropriate adjustments were made to ensure the inventory quantities in PeopleSoft agreed with the quantities of inventory on-hand in the storeroom.

**Refer to Attachment B Items Received and Not Putaway in PeopleSoft Before Inventory Manchester.*

A summary of the inventory cut-off test results for requisitions and receivers is included in the following table.

Location	Number of Requisitions and Receivers Examined	Number Processed According to Cut-Off Instructions	Number Not Processed According to Cut-Off Instructions	Description of Exception Items
Manchester	20	15	5	5 of the last 5 inventory receivers (#260182, #260483, # 260484, #260485, and #260486) processed before inventory at Manchester included items that were physically added to the shelves on 3/1/18 (before inventory) but were not processed and putaway in PeopleSoft until 3/26/18 (after inventory).
South Hills Junction	20	20	0	No exceptions noted.
South Hills Village	20	20	0	No exceptions noted.
Totals	**60**	**55**	**5**	

Business Impact

Failure to follow inventory cut-off instructions increases the risk that the value of inventory may be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 1

Internal Audit Department personnel are cognizant of the fact that PAAC is potentially transitioning to a new Maintenance Work Order System (MWOS) to be utilized for daily operations (to include inventory) that will affect the manner in which PAAC's Annual Physical Inventory is performed. If this new system is instituted in FY 2019, it is planned that PAAC will not need to cease operations to perform the physical count, and will minimize the movement of materials and document everything that occurs in the locations/garages during that time period.

In the event that PAAC continues to perform Annual Physical Inventory in the same manner as previous years, going forward we recommend the following:

1) Before shutting down the business units for Inventory, supervisory personnel at Manchester should verify that all items that are physically received at the dock are placed on the shelf and the put away process is completed in PeopleSoft. This should help ensure the accuracy of the inventory count.

2) The Manager of Inventory Operations and Distribution and supervisory personnel should run the INP 6600 Receiving Report or PAG_RECEIPTS Query in PeopleSoft to determine if there are any items that appear on this report that have been received after the designated cut-off date (to be determined) and, if so, complete the putaway process in PeopleSoft for these items. Storeroom and supervisory personnel should then inform the Manager, Purchasing Materials that the putaway process has been completed for all items that have been physically received and placed into inventory.

3) The Manager, Purchasing Materials should verify with the Manchester 2nd shift supervisor that the putaway process is complete and confirm by reviewing the PAG_RECEIPTS Query in PeopleSoft and, if items need putaway, the 2nd shift supervisor or warehouse personnel should manually put the items away in PeopleSoft.

4) All items received at the dock at Manchester (after inventory shutdown) should be held at the dock until after the physical inventory when normal business activity resumes and, at which time, these items should be placed on the shelf and the putaway process completed in PeopleSoft.

MANAGEMENT RESPONSE 1

Management concurs with the recommendation and stated that if PAAC continues to perform the Inventory in the same manner as previous years:

1) Before shutting down the business units for Inventory, supervisory personnel at Manchester will verify that all items that are physically received at the dock are placed on the shelf and the putaway process is completed in PeopleSoft. To assist in accomplishing this process, we will shut down inventory (related to the receipt of goods) a day earlier (e.g. Wednesday) to ensure that there is sufficient time to receive items at the dock, place items on the shelf, and complete the putaway process in PeopleSoft before inventory.

2) The Manager of Inventory Operations and Distribution and supervisory personnel will run the INP 6600 Receiving Report or the PAG_RECEIPTS Query in PeopleSoft to determine if there are any items that appear on this report for items that have been received after cut-off and, if so, complete the putaway process in PeopleSoft for these items. Storeroom and supervisory personnel will then inform the Manager, Purchasing Materials that the putaway process has been completed for all items that have been physically received and placed into inventory.

3) The Manager, Purchasing Materials will verify with the Manchester 2nd shift supervisor that the putaway process is complete and confirm by reviewing the PAG_RECEIPTS Query in PeopleSoft and, if items need putaway, the 2nd shift supervisor or warehouse personnel will manually put the items away in PeopleSoft.

4) All items received at the dock at Manchester (after inventory shutdown) will be held at the dock until after the physical inventory when normal business activity resumes and, at which time, these items will be placed on the shelf and the putaway process completed in PeopleSoft.

Target date for Implementation: FY 2019 Annual Physical Inventory

OBSERVATION 2 – EMERGENCY REQUISITION PROCESS CAN BE IMPROVED

A summary of the inventory cut-off test results for Emergency Requisitions is included in the table below.

Location	Number of Emergency Requisitions Reviewed	Number Processed According to Instructions	Number Not Processed According to Instructions	Description of Exception Items
Manchester	29	0	29	The items removed from stock before the inventory were either not added to the quantity counted during the initial count for 28 items on these Emergency Requisition and/or processed as a depletion in PeopleSoft prior to the final pass of the Reconciliation report for 29 items.
South Hills Junction	0	0	0	The Storeroom Receiver informed the Internal Audit Department personnel that there were no Emergency Requisitions issued during inventory. No exceptions noted.
South Hills Village	11	11	0	No exceptions noted.
Totals	**40**	**11**	**29**	

Internal Audit Department personnel noted that the process for handling of emergency items at Manchester was not properly handled during the FY 2018 Annual Physical Inventory count as recommended in previous years. There were a total of 29 Emergency Requisition items at Manchester that Internal Audit Department personnel reviewed (100%). All 29 items were not properly processed because either the:

1) Inventory count was not recorded correctly in PeopleSoft for the Emergency Requisition items issued before the items were initially counted, and/or

2) Items were not depleted in PeopleSoft documenting the fulfillment of the requisition.

This situation became more challenging because the Emergency Requisition log was not completed by circling "BC" to note if the item was removed before it was initially counted or "AC" to note if the item was removed after it was initially counted;, therefore, making it difficult to determine the accurate item count of the specific item removed from stock as listed on the Emergency Requisitions.

As a result of not properly handling the processing of the Emergency Requisitions, the value of the inventory items and the on-hand quantities were recorded incorrectly in PeopleSoft. As a result of this audit, storeroom supervisory personnel at Manchester were made aware of the exceptions, and the appropriate adjustments were made to ensure the inventory quantities in PeopleSoft agreed with the quantities of inventory on-hand in the storeroom.

The 2018 Physical Count Instructions state the following:

1) Record storeroom name on the top of this form and record all items issued during the time period the system is shut during the inventory.

2) Circle "BC" if the item was removed before it was initially counted or circle "AC" if the item was removed after it was initially counted.

3) The Emergency Requisition log should be given to a Storeroom Supervisor or the designated Purchasing and Materials Management Department personnel to review before the final quantity is entered by data entry personnel before running the final pass of the Physical Accounting Reconciliation Report.

4) Provide a copy of this completed listing to Internal Audit Department personnel working at the location on the final day of the inventory.

Business Impact

Failure to properly follow the process for handling Emergency Requisitions increases the risk that the value of inventory may be misstated. In addition, items may not be available when needed or may be ordered when there is already an adequate quantity on-hand.

RECOMMENDATION 2

Internal Audit Department personnel are cognizant of the fact that PAAC is potentially transitioning to a new Maintenance Work Order System (MWOS) to be utilized for daily operations (to include inventory) that will affect the manner in which PAAC's Annual Physical Inventory is performed. If this system is instituted in FY 2019, it will make this recommendation obsolete in part because PAAC will not need to cease operations to perform the physical count, which includes minimizing the movement of materials and documenting everything that occurs in the locations/garages during that time period.

In the event that PAAC continues to perform Annual Physical Inventory in the same manner as previous years, the process used for handling Emergency Requisitions at Manchester can be improved before and during the inventory; and, going forward, we recommend the following at Manchester:

1) The Manager of Inventory Operations & Distribution should review the Emergency Requisition process with the assigned storeroom and supervisory personnel (on each shift and during inventory) who will be responsible for controlling and documenting emergency requisitions.

2) The Manager, Purchasing Materials and Manager of Inventory Operations & Distribution should ensure that:

    a) Counts for Emergency Requisition items are accurately entered in PeopleSoft, and

    b) Where necessary, the depletion process is completed in PeopleSoft for the same items on the final day of the Annual Physical Inventory.

3) The Manager, Purchasing Materials and Manager of Inventory Operations & Distribution should inform Internal Audit Department personnel, when they have

completed the Emergency Requisition process of accurately entering the item count and, where necessary, complete the depletion process in PeopleSoft on the final day of the Annual Physical Inventory.

MANAGEMENT RESPONSE 2

Management concurs with the recommendation and stated that if PAAC continues to perform the Inventory in the same manner as previous years:

1) The Manager, Inventory Operations & Distribution will review the Emergency Requisition process with the assigned storeroom and supervisory personnel, who are responsible for controlling and documenting emergency requisitions, on each shift and during the Inventory process.

2) The Manager, Purchasing Materials and Manager, Inventory Operations & Distribution will ensure that:

    a) Counts for Emergency Requisition items are accurately entered in PeopleSoft, and

    b) Where necessary, the depletion process is completed in PeopleSoft for these same items on the final day of the Annual Physical Inventory.

3) The Manager, Purchasing Materials and Manager, Inventory Operations & Distribution will inform Internal Audit Department personnel, when they have completed the Emergency Requisition process of accurately entering the item count and, where necessary, complete the depletion process in PeopleSoft on the final day of the Annual Physical Inventory.

Target date for Implementation: FY 2019 Annual Physical Inventory

OBSERVATION 3 – INACTIVE ITEMS INCLUDED IN THE INVENTORY

At the time of inventory, we observed that there were a total of 203 inactive stock items listed on the Shut-Down queries/reports provided by the Manager, Purchasing Materials. These inactive stock items had an average unit cost of $2.00 or greater. The items listed on the Shut-Down queries/reports were compared to the Inventory Count Sheets to determine if any of these inactive items were counted during the FY 2018 Annual Physical Inventory. Below is a table that shows the number of inactive items by location and whether they appeared on the count sheets and were physically counted during the FY 2018 Annual Physical Inventory

Location	Number of Inactive Items Listed on the Query Generated by Purchasing and Materials Management Department Personnel*	Inactive Items listed on Inventory Count Sheets	
		Yes, and Counted	No, and Not Counted
Manchester	14	13 (S = 2)	1 (S = 1)
South Hills Junction	4	4 (S = 0)	0 (S = 0)
South Hills Village	4	4 (S = 1)	0 (S = 0)
Ross garage	31	26 (S = 4)	5 (S = 0)
Collier garage	40	40 (S = 3)	0 (S = 0)
West Mifflin garage	69	68 (S = 1)	1 (S = 0)
East Liberty garage	41	41 (S = 0)	0 (S = 0)
Total	**203**	**196** (S = 11)	**7** (S = 1)

S = Item was scrapped.

*All inactive items were identified as inactive at the Business Unit level on the Purchasing and Materials Management Department query. In addition, 25 of the 203 Business Unit level inactive items were identified as active at the item level on the Purchasing and Materials Management Department query. Inventory items can be classified in PeopleSoft as active and/or inactive at the Business Unit or item level depending on the item's activity/use at PAAC. PeopleSoft item status classification of active/inactive is one of the techniques that PAAC uses to manage inventory.

NOTE: The items referenced as scrapped (above) showed a scrap transaction code (051-Inv Scrap) on the Review Transaction History screen in PeopleSoft.

Previously, management stated that inactive items should not be included in Inventory and these stock items should either be active, because they still have a potential use at Port Authority, or inactive because they have been scrapped.

Business Impact

If inactive items that are scrapped remain in inventory, adequate space may not be available to store new and existing inventory items and additional time may be required to complete the inventory as the result of counting items that may no longer have use at Port Authority.

RECOMMENDATION 3

In order to potentially free up space in the storerooms for new and existing inventory items and ensure that items that should be scrapped are properly resolved, Purchasing and Materials Management personnel should:

1) Work with appropriate storeroom and supervisory personnel to revise and document (in writing) the inventory scrap process for Port Authority's inactive and obsolete inventory items.

This process should consider (but is not limited to) the following:

a) Identifying, limiting and controlling the number of personnel authorized to change the status of an inventory item (active and inactive) and complete the scrap process.

b) Defining an "inactive" inventory item at the business unit and item level.

c) Informing and instructing appropriate personnel, responsible for changing the status of an inventory item to active/inactive and completing the scrap process, of the revised process to ensure they are aware the procedure.

d) Monitoring the scrap process for inactive items that have been determined to be obsolete and ensure these items have been carried through the complete scrap process (the items are actually scrapped, the bin tag is removed and the item is moved to the "none" bin in PeopleSoft).

e) Determining the frequency of running a query to verify that the scrap process has been completed for the inactive/obsolete inventory item.

2) Once this revised scrap process has been developed, identify all inactive items that are currently included in Inventory. These items should be reviewed and:

a) Should either be activated and maintained in Inventory, if they can still be used as part of Port Authority business operations, or they should be removed from Inventory and taken through the entire scrap process, if they are obsolete and not being used, and

b) Management should verify that the scrap process for these inactive items that have been determined to be obsolete has been carried through to completion and Internal Audit Department personnel should be notified once the scrap process for these items has been completed.

MANAGEMENT RESPONSE 3

Management concurs with the recommendation and will:

1) Work with appropriate storeroom and supervisory personnel to revise and document (in writing) an improved inventory scrap process for Port Authority's inactive and obsolete inventory items.

This process will consider the following:

a) Identifying, limiting and controlling the number of personnel authorized to change the status of an inventory item (active and inactive) and complete the scrap process.

b) Defining an "inactive" inventory item at the business unit and item level.

c) Informing and instructing appropriate personnel, responsible for changing the status of an inventory item to active/inactive and completing the scrap process, of the revised process to ensure they are aware the procedure.

d) Monitoring the scrap process for inactive items that have been determined to be obsolete and ensure these items have been carried through the complete scrap process (the items are actually scrapped, the bin tag is removed and the item is moved to the "none" bin in PeopleSoft).

e) Approximately 2 months before inventory shutdown, Purchasing and Materials Management personnel will run a query to verify that the scrap process has been completed for the inactive/obsolete inventory item.

Target date for Implementation: Implemented

2) Once this improved scrap process is developed, Purchasing and Materials Management personnel will identify all inactive items that are currently included in Inventory. These items will be reviewed and:

a) Will either be activated and maintained in Inventory, if they can still be used as part of Port Authority business operations, **or** they will be removed from Inventory and taken through the entire scrap process, if they are obsolete and not being used, and

b) Management will verify that the scrap process for these inactive items that have been determined to be obsolete has been carried through to completion and Internal Audit Department personnel will be informed once the scrap process for these items has been completed.

Target date for Implementation: Before FY 2019 Annual Physical Inventory

ADVISORY COMMENT 1 – MARKING ITEMS WITH OVERFLOW STOCK AT SOUTH HILLS JUNCTION

We noted multiple instances at South Hills Junction where items with overflow stock were not marked. As a result, additional time was needed by the inventory count crews and by Internal Audit Department personnel to verify/confirm and count some of the inventory items. In addition, if overflow stock is not adequately marked, Stockroom personnel unfamiliar with the location may have difficulty locating items and may order items when there is already an adequate quantity on-hand.

RECOMMENDATION

All bins with overflow stock should be clearly marked and the overflow stock itself should be clearly marked.

MANAGEMENT RESPONSE

Management stated that some items, such as a spool of wire that was not physically located at the location listed on the count sheets was being stored at another location (outside in a shipping container) which had been moved by Power and Signal Department personnel and the receiver was not timely notified. In addition, some items with overflow stock were placed in a non-default bin location; however, overflow stock signs were not used for these items.

Overflow stock signs were printed and were used in some areas but not in others. It is Purchasing and Materials Management personnel's goal to ensure the use of overflow signs in all stockrooms.

ADVISORY COMMENT 2 – IMPROVING INTERNAL CONTROLS FOR PARTS ROOMS

We observed the following:

1) Currently PAAC's parts rooms/cages where Inventory parts are located at seven (7) locations (that are included in the Inventory) are not equipped with cameras.

2) Parts rooms are not staffed with a receiver (who is responsible for recording inventory transactions in the storeroom) at all times during maintenance hours.

    - Specifically, no parts rooms are staffed during weekend maintenance hours (during any shift) or on the third shift at most parts rooms locations. See table below.

    - The practice of not staffing parts rooms with receivers during specific periods was a management decision to attempt to control costs. Previously, management stated that they have attempted to mitigate the associated risks by securely storing some items in protected/locked areas.

The following table details by location, the value of Inventory, hours maintenance is performed, receiver staffing shift information and number of hours/percentage when receivers are not on duty to weekly hours maintenance performed.

Location Name	Value of Inventory (as of 7/5/18 Inventory)	Hours Maintenance Function Performed	Times When Parts Room Staffed by Receiver	Weekly Hours Maint. Performed	Weekly Hours Receiver on Duty	Weekly Hours Receiver Not on Duty	% of Hours Receiver Not on Duty to Weekly Hours Maint. Performed
Manchester	$7,517,830.98	First shift, Monday through Friday Second shift (only if they work overtime)	First shift (2 receivers) and second shift (1 receiver), Monday through Friday (Stockroom personnel are also present)	80	80	0	0.00%
South Hills Village	$5,096,407.20	24 hours a day, seven days per week	First shift (2 receivers) and second shift (1 receiver), Monday through Friday (Stockroom personnel are also present)	168	120	48	28.57%
South Hills Junction	$2,331,214.69	24 hours a day, seven days per week	First, second and third shift, Monday through Friday (SHJ-2 Receivers)	168	120	48	28.57%
East Liberty	$261,669.64	24 hours a day, seven days per week	First, second and third shift, Monday through Friday	168	120	48	28.57%
West Mifflin	$236,791.35	24 hours a day, seven days per week	First, second and third shift, Monday through Friday	168	120	48	28.57%
Ross	$202,120.15	24 hours a day, seven days per week	First and second shift, Monday through Friday	168	80	88	52.38%
Collier	$173,232.42	24 hours a day, seven days per week	First and second shift, Monday through Friday	168	80	88	52.38%

Note – PAAC also has an Auto Shop located at South Hills Junctions where non-revenue vehicles are serviced. Inventory information (value of inventory, staffing etc.) is not included in the table above, because currently everything purchased at the Auto Shop (inventory/supplies/tires/services) are purchased on an as-needed basis utilizing Purchase Orders (PO) and not recorded as inventory in PeopleSoft but rather are expensed as they are purchased.

The FY2018 Auto Shop purchase orders (7/5/17 – 6/28/18) totaled approximately $390,313.45.

The Auto Shop parts rooms/cages are not equipped with cameras, staffed with a receiver, or locked at all times. Parts are accessible to all personnel from 7:00 am to 12:00 am Monday through Friday and the rooms are locked at all other times. However, management stated batteries are controlled in a secured/locked area.

Business Impact

Although the practice of not staffing the parts rooms full-time may be cost effective, it may make managing materials from receipt to requisition and identifying reasons for inventory shortages more difficult. For example, if parts are required during a period when a parts room is not staffed with a receiver, there is a risk that maintenance personnel/supervisors access the parts rooms, obtain the needed parts and may not document and/or may not accurately document the requisition or return of an item. This may result in inaccurate quantities in PeopleSoft and inaccurately reflect the cost of vehicle maintenance.

However, in performing the annual inventory audits and throughout the audit process, Internal Audit Department personnel assess risks that are significant within the audit objectives. If risks are identified, procedures may be designed to obtain reasonable assurance of detecting any significant matters. In addition, Purchasing and Materials Management personnel stated that they utilize variance reports/reconciliation reports to analyze variances in an effort to determine, control and correct the discrepancies.

RECOMMENDATION

To assist with managing and controlling inventory and identifying reasons for inventory shortages, more accurately reflect the cost of vehicle maintenance and to mitigate risk to an acceptable level, we recommend management should determine the most effective approach to tracking the receipt and requisition of parts and review the cost effectiveness of the following:

- Installing cameras where all parts/supplies are located to assist in securing parts and supplies and the visual confirmation of receipt/requisition (tracking) of parts and access to parts by personnel, and

- Receiver staffing levels and hours to determine if the parts rooms are staffed to a sufficient level during all maintenance hours and/or if additional receivers are needed.

MANAGEMENT RESPONSE

Purchasing and Materials Management personnel stated that they will investigate/review the cost effectiveness of:

- Installing cameras where all parts/supplies are located, and
- Receiver staffing levels/hours to determine if parts rooms are staffed to sufficient levels during maintenance hours and/or if additional receivers are needed.

Target date for Implementation: Review during the 2020 budget process.

FOLLOW UP ON OUTSTANDING AUDIT RECOMMENDATIONS FROM PREVIOUS AUDITS

The recommendations made during previous audits are closed.

ACKNOWLEDGEMENTS

Members of the Internal Audit Department thank Tony Trona, Director of Purchasing and Materials Management; Justin Cava, Manager, Purchasing Materials; Mike Musillo, Manager, Inventory Operations and Distribution; Bernie Faccenda, Assistant Manager, Inventory; Tom Kaczmarski, Stores Supervisor–FL; Tim Bell, Stores Supervisor-Rails; Jason Lamb, Stores Supervisor–Relief-FL; inventory counters; and data entry clerks for their cooperation and assistance during this audit.

Participating auditors were Sheila Dillard, Maria Nickerson and Marsha McCall.

per Maria Nickerson — September 28, 2018

Sheila Dillard, Director, Internal Audit Department — Date

Disclaimer:

This report is intended solely for the information and use of Port Authority management for decision making purposes. It is not intended for use by any other party.

ATTACHMENT A – BUSINESS PROCESS FOR PUTAWAY AND DEPLETION

Putaway Process:

When an inventory item arrives at the receiving dock, the receiver takes possession of it and enters the receiving information into PeopleSoft, which then stages the batch of items that are to be placed into the Inventory. The stockperson then places the items into the correct bin in Inventory. At the Manchester and South Hills Junction locations, the Storeroom Supervisor runs a process called "Complete Putaway" which increases the on-hand quantities for all items that are in the staged batch status. At the South Hills Junction location, the "Complete Putaway" process is done at the time of receiving the item. At the South Hills Village location, the "Complete Putaway" process is run automatically as part of the receiving process.

Depletion Process:

When an item needs to be removed from Inventory, the employee who needs it initiates the process by submitting a material stock request online in PeopleSoft. PeopleSoft includes this item on its pick list, which is generated nightly. After the item has been picked from the shelf, the supervisor provides feedback to PeopleSoft to notify the system that the item is no longer in Inventory. At South Hills Village, a batch process runs every half hour to look for new material stock requests and a Pick Sheet prints at the stockperson's printer. The stockperson then fulfills the order and closes the order in the system by performing the "Material Picking Feedback" process, which confirms, ships and depletes the items that have been fulfilled. At all locations the depletion process is run nightly to automatically, reduce on-hand quantities for which feedback has been entered into PeopleSoft.

ATTACHMENT B – ITEMS RECEIVED AND NOT PUTAWAY IN PEOPLESOFT BEFORE INVENTORY - MANCHESTER

Count	Stock Item ID #	Description	Quantity Received	Unit Price	Dollar Amount Received
1	671102	Tubing Heat Shrink 1.5 X 48" Black Thin Wall	10	$7.85	$78.50
2	815106	Crackshaft, Engine - ISL	1	1,650.00	1,650.00
3	815288	Cylinder Block - ISL - Core Needed	1	2,200.00	2,200.00
4	245028	Sensor, NOX - SCR	4	389.19	1,556.76
5	475021	Sensor, Pressure High, Injector	5	86.36	431.80
6	661105	Bulb Pit Light Frosted Rough Service 50W 120V A19	120	0.68	81.60
7	816004	Radiator/CAC Assembly (ISL Only) - Core Needed	1	2,200.00	2,200.00
8	720411	Blades H.D. Utility Knife	300	0.69	207.00
9	850192	Meter, Flexible Electronic Lube	4	221.00	884.00
10	700960	Paper Toilet Tissue 2 Ply 500 SH/Roll 96 RO/CS	20	35.76	715.20
11	974015	Cap, Oil Fill Transmission Dipstick	4	189.14	756.56
12	400007	Foam, Poly, Back - USSC	12	71.91	862.92
13	879095	Coil-24V-Water Valve	5	29.98	149.90
14	840889	Clamp Silicone Hose 2 1/4 to 3 1/8 CNST/Tork	200	4.54	908.00
15	795227	Clamp, 13/16 - 1-1/2 CNST/Tork	200	3.32	664.00
16	840881	Clamp Silicone Hose 9/16 to 1-1/16 CNST/Tork	100	3.11	311.00
17	900040	Bumper Assy Front	4	994.60	3,978.40
18	791366	Insulator Rubber Insert	12	2.33	27.96
19	963008	Adjuster Slack Left Front	60	65.94	3,956.40
20	545001	Belt Water Pump	72	22.11	1,591.92
21	545100	Mount, Engine Rear Cushy Float	12	50.75	609.00
22	768501	Filter Fuel, Engine	400	7.25	2,900.00
23	903512	Rod Torque Upper Front (19")	32	179.80	5,753.60
24	479002	Pulley, Clutch	2	359.89	719.78
25	235000	Blanket, Exhaust Bellows - See Comments	8	182.99	1,463.92
26	245049	Gasket Marmon 5" - SCR	9	6.91	62.19
27	248003	Tie Rod - Socket Assembly RH Thread	16	26.63	426.08
28	950072	Link, Saddle - Wiper System	40	6.67	266.80
29	243072	Transducer - Air	1	109.09	109.09
30	230027	Flexible Floor Assembly - Bellows - NF	1	2,201.15	2,201.15
31	240142	Cover Hip Boot	2	907.83	1,815.66
32	240023	Module Rubber Corner Black-Streetside Rear	4	290.43	1,161.72
33	240025	Module, Rubber Corner Black-Curbside Rear	6	290.43	1,742.58
Total					42,443.49