



# INTERNAL AUDIT REPORT

## Inventory Management

R-18-07

December 13, 2018

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# Executive Summary

## Introduction

In conjunction with the Board of Trustees' Audit Committee, Internal Audit (IA) developed a risk-based annual audit plan. All of the audits on the audit plan are conducted in accordance with the International Standards for the Professional Practice of Internal Audit, published by the Institute for Internal Auditors (IIA), and provide several benefits:

- Management's continuous improvement efforts are enhanced
- Compliance is verified and shortfalls are identified so that they can be corrected
- Board of Trustee oversight of governance, control and risk management is strengthened

All of these benefits contribute toward the Board of Trustees' strategic plan focus areas of:

- Customer Service – Improve products, services, accessibility, and mobility
- Leadership and Advocacy – Address current and future transportation challenges
- Access to Opportunity – Enrich transit access and quality of life
- Strategic Funding – Be wise stewards of public resources
- Workplace of the Future – Foster dynamic, diverse, and engaged employees

As part of the 2018 audit plan, IA was directed by the Board of Trustees to perform an audit to determine if controls over Inventory Management are designed and operating effectively to ensure that inventory is physically protected, accurately and effectively tracked, as well as appropriately valued. The preliminary stage of the audit was concluded in November 2017 and the final audit was completed in September 2018.

## Background and Functional Overview

The Vice President (VP) of Finance for the Utah Transit Authority (UTA), provided a functional overview of Inventory Management processes to provide context to this report. Please note that all of the information, including totals, figures, and percentages, are assertions made by the Vice President of Finance and were not assessed by Internal Audit.

UTA's service requires that a sizeable fleet of safe and well-functioning buses, vans, and light rail and commuter rail vehicles be available every day for 362 days a year. Also essential are well-functioning system components (e.g., rail switches, crossing lights and crossbars, and customer information boards), facilities, and supporting equipment. UTA's maintenance departments are charged with ensuring the daily fleet needs are met and that system components are functioning. To efficiently and effectively meet the daily demands before them, maintenance personnel must have the right parts available when they need them. Buying, stocking, and delivering the right parts when needed is the responsibility of Supply Chain.

Supply Chain's work includes minimizing inventory and parts costs while supporting the agency's core mission of providing safe, reliable and high-quality transit service. In addition to assisting maintenance in meeting daily vehicle and system component requirements (service focus), Supply Chain is also charged with running a well-managed inventory system which minimizes spoilage, parts costs, warehouse inefficiencies, and overall inventory investment (stewardship focus). Inventory is stored in warehouses located at Meadowbrook, Jordan River, and Warm Springs locations as well as in parts rooms at six UTA sites.

Some initiatives which have been put in place to improve parts availability include:

- Operations and Supply Chain have developed better forward-looking modeling for regular and cyclical maintenance parts needs
- A new inventory reorder-point calculation was put in place to account for delivery lead-times from suppliers and subsequent appropriate inventory levels
- Reordering models have been changed to increase inventory of low-cost parts
- Staff has worked with key vendors to understand their production cycle and ordering models have been adjusted accordingly
- Frequently needed supplies have been moved from the parts room to the point of use at the mechanics' work site
- Parts rooms have been rearranged to place frequently used parts closest to the parts counter

One key performance goal for Supply Chain is to have the right part on hand when a mechanic needs it 95% of the time, which is the industry best practice standard. Parts availability by parts room has improved significantly from January 2015 to November 2017, to an overall average of 94%.

Every three years, the Federal Transit Agency (FTA) performs a Triennial Review which includes evaluation of UTA's compliance with best procurement and inventory practices. There were no findings regarding procurement or inventory in the 2013 and 2016 Triennial Reviews

### **Objectives and Scope**

The period of the preliminary audit was September 1, 2016, through August 31, 2017 with the completion of the audit work focusing on April 1, 2018 through August 31, 2018..

The primary areas of focus for the Inventory Management audit were:

- All warehouses and parts rooms for Bus, Light Rail, and Commuter Rail locations
- Inventory receiving and distribution
- Inventory tracking and controlling
- Issuing of inventory
- Stock counts
- Warranties

The internal audit excluded from the scope of this audit areas such as:

- Non-inventory items
- Inventory procurement process
- Inventory accounts payable process
- Fuel and oil

## Audit Conclusion

### Audit Report Rating\*

Stronger governance has been designed and implemented for the Inventory Management process with the approval of Corporate Policy No. 2.1.15, Inventory Management (Policy), in September 2018. The Policy assigns Supply Chain overall authority over inventory management processes. The Policy also includes roles and responsibilities and certain procedures for key activities such as receiving, tracking, distributing and safeguarding of inventory. The Policy was not approved until after the audit period, resulting in many risks identified in the preliminary assessment persisting throughout the audit period.

Inventory Management had previously developed a series of flowcharts and other process documentation that were referenced in the Policy as processes and procedures. IA acknowledges Inventory Management's efforts in establishing the Policy and process documentation to guide parts clerks and warehouse staff. However, IA noted that the referenced documents did not contain all aspects required to be considered Standard Operating Procedures, which IA recommends be developed. Missing elements include, but were not limited to, identification of critical controls, alignment with policy objectives, required reports and documentation, and required approvals.

Management has segregated warehouse and parts room duties from centralized inventory control, but all segregation of duties concerns have not been addressed. Inventory counts were one such area of concern in that the same staff that has custody of inventory performs inventory counts. Corporate Policy No. 2.1.15, Inventory Management includes requirements for supervisory review of counts and for different individuals to conduct 2<sup>nd</sup> and 3<sup>rd</sup> counts when discrepancies were noted. The effectiveness of these mitigating controls could only be partially tested because the Policy had not been adopted and therefore the requirement had not been fully implemented. A formal, documented risk assessment of the Inventory Management process, including the costs versus benefits of existing deployment of staff may identify opportunities for additional segregation of duties or additional compensating controls.

As part of the Policy, and in advance of its approval, Inventory Management has implemented additional supervisory monitoring and review of inventory transactions such as adjustments and out-of-stock orders.

This is the first internal audit of Inventory Management and overall, the audit found that there are pockets of excellence, but further work is required to improve the overall governance and control environment.

While this report details the results of the audit based on limited sample testing, the responsibility for the maintenance of an effective system of internal control and the prevention and detection of irregularities and fraud rests with management.

\*Rating is defined in Appendix 2

Internal Audit would like to thank management and staff for their co-operation and assistance during the audit.

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## 1. Governance

Preliminary Finding R-17-13-1	High
<p>Criteria:</p> <p>Enterprise governance is an overarching system, which seeks to align priorities, funding, and resources and elevates decision making responsibility, authority, and accountability to the appropriate levels. Governance principles include:</p> <ul style="list-style-type: none"><li>• Management establishes reporting lines, with board oversight, of the development and performance of internal control</li><li>• Individually establishes accountability for internal control responsibilities in pursuit of entity objectives</li></ul> <p>Sources: COSO Enterprise Risk Management: Establishing Effective Governance, Risk, and Compliance (GRC) Processes, Robert R Moeller COSO: How the COSO Frameworks Can Help, James DeLoach and Jeff Thomson</p> <p>Condition:</p> <ul style="list-style-type: none"><li>• While there were Board and corporate policies on protection of assets, there was no written corporate level policy regarding inventory management</li><li>• Written standard operating procedures (SOPs), available on the UTA Intranet, were obsolete and incomplete</li><li>• Current flowcharts and other process documentation had been developed for several areas but they did not include elements required to be considered SOPs and did not include all inventory management processes</li></ul> <p>Root/Cause Analysis:</p> <ul style="list-style-type: none"><li>• The ERP Tech Sys Admin-Supply Chain and the Warehouse &amp; Inventory Opns Mgr did not understand that they have the authority to set policies for all Business Units (BUs) involved in the process</li><li>• Management relied on the expertise of existing staff rather than a set of documented procedures to direct users in the process</li></ul> <p>Effect:</p> <ul style="list-style-type: none"><li>• Overall authority, responsibility, and accountability for inventory management, from purchase to use, was not clearly defined between Supply Chain, Maintenance, and Operations Divisions which may lead to:<ul style="list-style-type: none"><li>○ Inconsistent practices, inefficiencies, and misuse</li><li>○ Higher potential for errors and omissions</li><li>○ Missed opportunities for continuous improvement</li></ul></li></ul>	
<p><b>Recommendations</b></p> <p>Management should formally assign overall authority, and areas of responsibility, for the inventory management process. Ideally, such assignment would be done through a corporate policy to clarify authority to direct the activities of the inventory management process across BUs, reporting lines, and functions (as needed).</p> <p>Management should create an SOP to direct users in the inventory management process, following best practices. Processes currently documented through flowcharts and work instructions should be</p>	

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included in an SOP. At a minimum, the following areas should also be included: parts inventory organization, tagging, and distribution; required environmental and access controls; maintenance of master data; disposals, write offs and adjustments; planning and reconciling cycle counts; and warehouse receiving.

After SOPs have been created, management should train all inventory management employees on them and create a centralized record of personnel training in order to assess completeness of the employee training process.

Management Agreement	Owner	Target Completion Date
Yes	VP of Finance	3/31/2018

By the target completion date the Supply Chain group will create an Inventory Management Corporate Policy to incorporate the areas listed above and submit it to the policy committee for approval. This Corporate Policy will set forth policy at a high level that will apply to all business units and warehouses. Once the policy is finalized we will train all employees affected by the policy.

Final Status	Medium
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Corporate Policy No. 2.1.15, Inventory Management (Policy), was developed by Supply Chain, with input from the business units, and was signed, subsequent to the audit period, by the Interim Executive Director on September 10, 2018. The policy assigns Supply Chain overall authority of inventory management processes. The Policy included provisions regarding inventory organization, tagging, and distribution, access controls, maintenance of master data, disposals, write offs, adjustments, planning and reconciling cycling counts and receiving. However, there were no provisions noted for appropriate environmental controls, which IA recommends be included in future updates of the policy.

Given that the Policy was approved after August 31, 2018, risks identified in the preliminary assessment persisted during the audit period. Also, certain control activities, such as staff training on the Policy, could not be audited because it was not yet in place.

The Policy included procedures as well as policy statements and incorporated existing flowcharts and other process documentation, by reference, under Section XII, Processes and Procedures. IA acknowledges Inventory Management's efforts in establishing the Policy and process documentation to guide parts clerks and warehouse staff. However, best practices recommend that policies set forth process objectives and roles and responsibilities. Procedures, on the other hand, should describe the steps required to ensure that process objectives set forth in policy are to be achieved. Therefore, IA recommends that Inventory Management review Corporate Policy to ensure the document includes process objectives and roles and responsibilities. SOPs should then be developed for key areas of inventory management, and should include the following elements:

- Identification of the critical controls in the process that align the procedures with applicable policy
- Reports or other process documentation to be created and retained
- Acceptable methods of communication between parties and when it is required (i.e. verbal, email, etc.)
- How evidence of required approvals should be documented

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Management Agreement	Owner	Target Completion Date
Yes	VP of Finance	6/1/2019
<p>There is a project underway within UTA Legal and Records Retention to identify the information to be contained within a Corporate Policy and a Standard Operating Procedure. Part of this project is to create a standard template to be used by all departments at UTA. Once this project is complete and the templates created, Supply Chain will review our Policy and align it with the defined guidelines.</p> <p>While there are some parts or equipment that may be susceptible to environmental conditions steps have been taken to ensure these items are not damaged, or cause damage, such as covers, stored indoors, or containment pallets used.</p> <p>Additional policies, procedures, and/or work instructions will be added to the revised documentation.</p>		

## 2. Segregation of Duties

Preliminary Finding R-17-13-2	High
<p>Criteria:</p> <p>A fundamental element of internal control is the segregation of certain key duties. The basic idea underlying segregation of duties (SOD) is that no employee or group of employees should be in a position to conceal errors or misuse in the normal course of their duties. In general, the principal incompatible duties to be segregated are:</p> <ul style="list-style-type: none"> <li>• Custody of assets</li> <li>• Authorization or approval of related transactions affecting those assets</li> <li>• Recording or reporting of related transactions</li> </ul> <p>Systems of internal control rely on assigning certain responsibilities to different individuals by segregating incompatible functions. The general premise of SOD is to prevent one person from having both access to assets and responsibility for maintaining the accountability of those assets.</p> <p>Source: IIA <a href="https://iaonline.theiia.org/simplifying-segregation-of-duties">https://iaonline.theiia.org/simplifying-segregation-of-duties</a></p> <p>Condition:</p> <p>Inadequate SODs were noted in the following:</p> <ul style="list-style-type: none"> <li>• ERP System Access controls: <ul style="list-style-type: none"> <li>○ With the exception of part number changes, there were no documented procedures regarding changes to master data, nor the procedures to be followed</li> <li>○ There was no documented review and approval by business units, or other independent party, of master data changes</li> <li>○ Any parts or warehouse clerk was able to create an out-of-stock for any location. Warehouse staff could issue parts to a work order at any location. Staff at Jordan River and Midvale locations could create out-of-stocks and issue parts to either location</li> <li>○ Bus Supervisors and a Production Control Specialist had access to both Parts Inventory and Maintenance ERP system applications</li> </ul> </li> </ul>	

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- Nine warehouse staff had access to Parts Inventory and Purchase Order ERP system applications
- Parts and Inventory Supervisors had access to Work Order ERP System applications
- The Maintenance Systems ERP Admin had access to Issue parts as well as acting as the ERP Super User for Maintenance
- No user access form was in place for a contractor with Super User level access to Supply Chain applications
- Receiving, distribution, transfers and parts issuance:
  - Warehouse staff review of packing slip entries into the ERP System included the packing slips that the reviewer originally entered
  - Parts were released by the Warehouse Specialist without an independent review of parts to be shipped
  - Couriers accepted custody of parts for delivery without documented physical or electronic acknowledgement and acceptance. In addition, there was no “in-transit” status for items being routed to a new location
  - Parts rooms accepted custody of parts without documented physical or electronic acknowledgement or acceptance
  - Management did not perform reviews to determine whether distributions of parts were accurate, appropriate, and complete
  - Parts were issued by parts room staff to open work orders with no documented physical or electronic acknowledgement and acceptance by Maintenance
- Inventory counts
  - Warehouse and parts room staff performing inventory counts were the same individuals responsible for the parts on a daily basis
  - Recounts were sometimes performed by the initial counter
- Adjustments and disposals
  - There was no formal review of adjustments to ensure that all adjustments were authorized, documentation was retained and were performed correctly
  - Items could be physically disposed of by the same party who has identified the need for the disposal
  - Parts may be deleted or disposed of within the ERP system without detection

## Root/Cause Analysis:

- Cross functional job duties resulted in access to maintenance and inventory application modules e.g. bus supervisors oversee both maintenance and inventory staff, the Production Control Specialist works in Production Control and at the Warehouse and staff at the Jordan River and Midvale locations provide coverage of both areas.
- Quarterly User Access Reports do not include all ERP application access nor do they flag potential SOD violations. SOD monitoring software was not in place.
- Inventory management cited technical constraints preventing a change to warehouse staff issue rights
- Management identified resource constraints as causing inadequate SODs
- Management relied on informal means of communicating areas of responsibilities rather than documented corporate policy
- Management relied on the expertise of existing staff rather than a set of documented SOPs to guide users in the process
- No formal, ongoing, and periodic risk assessment practice in place

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**Effect:**

Misuse and error may occur and not be detected in the absence of adequate SOD.

**Recommendations**

A comprehensive, ongoing, and periodic risk assessment of inventory management should be conducted. The risk assessment should include risks related to inadequate SODs.

Management should consider how resources may be best deployed to minimize lack of SODs and related risks. Additionally, management should consider implementing compensating controls, such as exception reports and reviews, to mitigate the risk of insufficient SODs due to resource constraints.

Management should include in SOPs what duties should be segregated within the ERP system and in daily operations and what reviews and sign-offs should be performed.

Management Agreement	Owner	Target Completion Date
Yes	VP of Finance	3/31/2018

By the target date the Supply Chain team will complete the following tasks. We will remove access to create work orders for the Parts and Inventory Supervisors. Access to modify POs by the warehouse staff will be reviewed and limited based on actual needed field access. Recounts of inventory will be conducted by a second person. A random review of 2 Inventory adjustments per month will be performed by management for document verification and approval. Created reports will be reviewed randomly, or for outliers. Monthly reports will be created where appropriate from an analysis of risk vs. benefit and logical labor use. All other processes and job assignments are as designed in order to maximize labor efficiencies or due to other resource constraints. A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment. SOD risk vs. cost/benefit will be considered in the creation of the Corporate Policy.

**Final Status**

**Medium**

A risk assessment for Inventory Management has not yet been performed. Management stated that a risk assessment was planned for January 2019.

IA recommends that a Risk Assessment of Inventory Management be performed, that all key processes be assessed for potential SOD violations and that those noted be individually evaluated based on costs versus benefits. Where SOD violations not already addressed cannot be eliminated, we recommend that Inventory Management design compensating controls, such as additional oversight.

During testing IA noted that Parts and Inventory Supervisors' access to create work orders, had been removed. However, 9 warehouse staff continued to have access to make changes to purchase orders (PO). An audit trail exists within JDE should questions arise, but PO modifications by warehouse staff are not currently monitored or reviewed, therefore the related risk remains.

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IA recommends that Management implement tolerance levels within the ERP system to allow warehouse staff to receive items in excess of those ordered, within a certain threshold, or implement compensating controls, such as monitoring and review of warehouse staff changes to PO values.

Inventory Management has created a repository for all adjustment documentation. In addition, the ERP Tech Systems Admin- Supply Chain conducted a random audit of two adjustments per month and ensured that documentation was saved to the repository and included appropriate authorization. IA selected 4 inventory adjustments for review and found that:

- Documentation for 1 of the 4 had not been not saved in the centralized file, although it was later provided.
- 3 out of 4 adjustments reviewed were authorized by a parts clerk or warehouse specialist and not a lead or supervisor.

IA noted that the Policy requires parts supervisor or lead approval whenever inventory adjustments are communicated. However, because the Policy was not approved until after the audit period, some business units elected to allow non-supervisory staff to communicate adjustments. The Policy did not include approval requirement for inactive inventory write off, which IA recommends be considered for future Policy updates.

In addition, IA recommends that all adjustment documentation be retained in the centralized file and that adjustments be authorized by a parts room supervisor or lead.

Parts clerks continued to be responsible for issuance, organization, and accuracy of inventory as well as for performing physical inventory counts for the same inventory. This was identified as inadequate SODs. The Policy includes the requirement that a supervisor approve inventory counts, however the Policy was not in force during the audit period, which resulted in the control not being implemented. The Policy also requires different staff to perform 2<sup>nd</sup> and 3<sup>rd</sup> inventory counts, which had been implemented. However, IA found that count sheets lacked evidence to support whether different staff conducted the counts. IA recommends that supervisors review and approve inventory counts and that Inventory Management develop procedures to ensure that the individual performing 2<sup>nd</sup> and 3<sup>rd</sup> inventory counts can be evidenced.

Management Agreement	Owner	Target Completion Date
Yes	VP of Finance	6/1/2019

Inventory Management reviews and audits system access rights quarterly to identify SOD concerns. A tolerance level is currently being implemented in the ERP system that will eliminate the need for Warehouse employees to modify POs. Once this is implemented, Warehouse employee access to modify POs will be removed.

The approval date of the new Policy to the audit date did not allow adequate time for IA testing to be validated to the policy. Inactive inventory reviews and write off approval process, and inventory count approval procedures will be established and either added to the current policy or new procedures as dictated by the new UTA policy template. Adjustment documentation procedures are already outlined in the new policy, however the audit period was performed prior to the new Policy approval.

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An annual risk assessment will be conducted in January 2019 will include all key processes. This assessment will include an evaluation of SODs. Supply Chain will inquire to see if there are risk assessment training opportunities for the department as well.

Relative to the SODs of the parts clerks, oversight of physical inventory counts is performed by Inventory Control as an unbiased 3<sup>rd</sup> party with ultimate authority and responsibility for inventory count integrity. Physical inventory count adjustments are reviewed and approved by the unit Supervisor or Manager.

As of January 2018 all adjustments documentation is being retained in a centralized shared drive.

### 3. Adjustments, Disposals, and Write Offs

Preliminary Finding R-17-13-3	High
<p>Criteria: Executive Limitations Policy No. 2.2.1 "Asset Protection," states, "Assets of the Utah Transit Authority shall not be unprotected, inadequately maintained, or unnecessarily risked. Accordingly, the General Manager shall not:</p> <ol style="list-style-type: none"><li>1. Fail to protect against:<ol style="list-style-type: none"><li>a. Property and casualty losses;</li><li>b. Public officials' errors and omissions and fiduciary liability;</li><li>c. Theft and fraud;</li><li>d. Loss of value, appearance, and utility of assets; and</li><li>e. Loss of or significant damage to intellectual property, systems, and records essential to the well-being of the Authority."</li></ol></li></ol> <p>Condition:</p> <ul style="list-style-type: none"><li>• 6 (of 25) items disposed of were not flagged in the ERP System to prevent re-orders</li><li>• BU approval was not on file for 4 (of 25) disposed items</li><li>• One back-to-stock transaction was miscoded as an adjusting transaction</li></ul> <p>Root/Cause Analysis:</p> <ul style="list-style-type: none"><li>• Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process</li><li>• A formal review process is not in place for adjustments, disposals, and write-offs</li></ul> <p>Effect: Adjustments, disposals, and write offs are more likely to be invalid, incomplete, or inappropriate without policies and procedures that include requirements for formal independent reviews and approval of activity.</p>	
<b>Recommendation</b>	
<ul style="list-style-type: none"><li>• Management should include a review and approval process for adjustments, disposals, and write-offs in an SOP, including individuals authorized to request an adjustment, what</li></ul>	

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<p>documentation should be retained to support an audit trail, and a way to ensure all adjustments entered into the ERP system are detected, reviewed, and approved.</p> <ul style="list-style-type: none"> <li>• Management should implement a periodic review and approval process of adjustments, disposals, and write-offs by an independent person.</li> </ul>		
Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	3/31/2018
<p>In the new Corporate Policy (item #1) approvals for adjustments, disposals, and write-offs will be required to be approved by the BU Lead or Supervisor position. A random review of 2 Inventory adjustments per month will be performed by management for document verification and approval. We will work with IT to identify the best method for a 1 year retention of adjustment approval documentation. A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment.</p>		

Final Status	Low	
<p>Management included a review and approval process for adjustments, disposals, and write-offs in the new Policy, as well as the individuals that are authorized to communicate an adjustment and what documentation should be retained to support an audit trail. Even though the Policy includes these adjustment requirements and reviews, it was not fully implemented during the audit period.</p> <p>In line with the Policy, the ERP Tech Systems Admin- Supply Chain conducted a random audit of 2 adjustments per month to ensure documentation was saved, matched the adjustment made in the ERP system, and included appropriate authorization.</p> <p>IA selected 4 adjusting transactions from June 2018 for testing, 2 of which were for disposal of obsolete inventory.</p> <ul style="list-style-type: none"> <li>• 1 out of 4 was not saved in the centralized repository, although it was later provided for review</li> <li>• 3 out of 4 were not authorized by a parts supervisor or lead</li> </ul> <p>Some business units allowed non-supervisory staff to communicate adjustments and elected to continue that practice until the Policy was approved. IA also noted that the Policy did not include the individuals that are authorized to communicate disposal of inactive or obsolete inventory write offs, which included two items in the audit sample.</p> <p>IA recommends that all adjustment documentation be retained in the centralized file, be authorized by a supervisor or lead, and that requirements for authorization of inactive or obsolete inventory write-offs be included in future Policy updates.</p>		
Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/1/2019
<p>Inactive inventory reviews and approval process will be established and either added to the current policy or new procedures as dictated by the new UTA policy template.</p> <p>As of January 2018 all adjustments documentation is being retained in a centralized shared drive.</p>		

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## 4. Inventory Counts

Preliminary Finding R-17-13-4	High
<p><b>Criteria:</b> Physical inventory counts are performed on a periodic basis to ensure that inventory records reflect actual quantities on hand.</p> <p><b>Condition:</b></p> <ul style="list-style-type: none"><li>• The same individuals responsible for stocking and issuing warehouse inventory performed inventory counts (Repeated condition from finding 2)</li><li>• The initials of the person performing the first and second recount were not recorded in the ERP System</li><li>• During inspection of count sheets provided for selected items, IA noted that not all count sheets had sign offs by two counters</li><li>• The Inventory Audit report generated by Inventory Control staff during entry of counts in the ERP system was not printed or retained</li><li>• There was no supporting documentation of supervisory spot checks of counts</li><li>• There was no requirement to lock the ERP system during the physical count</li><li>• During a physical count IA noted that inventory count sheets were completed in pencil</li><li>• For 3 (out of 25) inventory adjustments resulting from physical counts that were tested there was no record of a recount to support the adjustment</li><li>• New parts were excluded from inventory counts for the first year</li><li>• Inventory count instructions were not complete in guiding users what to do when a part's location on the count sheet was incorrect</li></ul> <p><b>Root/Cause Analysis:</b></p> <ul style="list-style-type: none"><li>• Management identified resource constraints as causing inadequate SODs</li><li>• Management preferred to rely on the same parts room staff responsible for daily inventory operations to perform counts for greater efficiency</li><li>• Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process</li><li>• No formal, ongoing, and periodic risk assessment practice in place</li></ul> <p><b>Effect:</b> System inventory may not reflect physical inventory, potentially resulting in inaccurate management information.</p>	
<b>Recommendations</b>	
<p>Management should consider how resources may be best deployed to minimize lack of SODs and related risks. Additionally, management should implement compensating controls that mitigate the risk of insufficient SODs where resource constraints prevent enforcement of SODs.</p> <p>Management should define the inventory count process and required controls in an SOP.</p> <p>Management should implement a formal review and approval process for Inventory Count sheets, ERP count entry, and related documentation by an independent person</p>	

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Management should assess the inventory count process risks as part of a formalized, comprehensive, and ongoing risk assessment for inventory management.

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	3/31/2018

Inventory counting conducted by an employee who is familiar with the inventory and is the “subject matter expert”, is a standard best practice in the Supply Chain field (example, see <https://www.ids-astra.com/blog/inventory-control-know-whats-on-shelves> ). Included in the Corporate Policy (item #1) we will implement a formal review and approval process of inventory counts by an independent person. SODs will include the use of different employees for 2<sup>nd</sup> and 3<sup>rd</sup> counts, and supervisor approval for inventory adjustments. The physical inventory Policy and will be outlined in the new Corporate Policy (item #1). A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment.

Final Status	High
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To address SODs, the Senior Supply Chain Manager, the Warehouse and Inventory Operations Manager, and the ERP Tech Systems Admin- Supply Chain met while drafting the Policy and discussed SOD violations identified in the preliminary assessment. No documented comparison of costs versus benefits was created for individual SODs. Even though SODs were discussed, parts clerks continued to be responsible for issuance, organization, and accuracy of the same inventory they perform physical inventory counts for.

IA noted that management defined some aspects and required controls for the inventory count process in the Inventory Management Policy, however, as noted, the Policy was adopted after the audit period. Before adoption of the Policy, adherence to its requirements was voluntary and therefore IA could not adequately test that required controls were followed.

IA noted that no SOP was created for the inventory count process in accordance with best practices, as noted above in Finding 1, which increases the risk that users performing inventory counts are not aware of required controls because they have not been documented or adequately communicated.

Per inquiry with management, the control, documented in the Policy, that requires different staff perform 2<sup>nd</sup> and 3<sup>rd</sup> inventory counts, had been implemented prior to the adoption of the Policy. IA tested a sample of 3 counts and found the following

- For 2 of 3 inventory counts tested there was no evidence of a different person performing recounts on the recount sheet
- For 1 of 3 counts where initials were provided as evidence of a different counter, 2 re-count sheets, out of 67 (3 percent), did not contain such evidence
- IA also noted that, although the system will record the initials of individuals performing a re-count if the quantity counted is different, it will not record the initials of the individual if the quantity counted is the same

In addition, IA did not find evidence that the results of the counts or the inventory adjustments made from count results were reviewed or approved by supervisory personnel. Furthermore, the Policy did not indicate a retention period for inventory count documentation by parts rooms.

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IA recommends the following:

- Inventory Management should develop SOPs which incorporate existing process flow documents for all critical Inventory processes. SOPs should, at a minimum, incorporate the required elements identified in Finding 1.
- Inventory Control personnel who oversee inventory counts should ensure that parts room supervisors review and approve inventory counts and that Inventory Management develop procedures to ensure that the individual performing 2<sup>nd</sup> and 3<sup>rd</sup> inventory counts can be evidenced.

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	3/31/2019

The approval date of the new Policy to the audit date did not allow adequate time for IA testing to be validated to the policy. Inventory count approval procedures, and reference to the existing work flow documents, will be established and either added to the current policy or new procedures as dictated by the new UTA policy template.

Relative to the SODs of the parts clerks, oversight of physical inventory counts is performed by Inventory Control as an unbiased 3<sup>rd</sup> party with ultimate authority and responsibility for inventory count integrity. Physical inventory count adjustments are reviewed and approved by the unit Supervisor or Manager.

## 5. Warehouse and Parts Room [REDACTED]

Preliminary Finding R-17-13-5	Medium
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Criteria:

Executive Limitations Policy No. 2.2.1 “Asset Protection,” states, “Assets of the Utah Transit Authority shall not be unprotected, inadequately maintained, or unnecessarily risked. Accordingly, the General Manager shall not:

1. Fail to protect against:
  - a. Property and casualty losses;
  - b. Public officials’ errors and omissions and fiduciary liability;
  - c. Theft and fraud;
  - d. Loss of value, appearance, and utility of assets; and
  - e. Loss of or significant damage to intellectual property, systems, and records essential to the well-being of the Authority.”

Condition:

- A risk exists that a person can remove/take inventory without the authority to do so
- A further risk exists that inventory authorized to be taken for maintenance and repairs are not recorded on the ERP System

[REDACTED]

[REDACTED]

[REDACTED]

# APPENDIX 1

- [Redacted] Mechanics retrieving inventory were relied on to write down what was taken for repairs and maintenance

Root/Cause Analysis:

- [Redacted]
- Inventory Management did not understand they held the authority for the overall inventory management process, including warehousing of parts
- Management relied on informal means of communicating areas of responsibilities rather than by documented corporate policy
- Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process
- No formal, ongoing, and periodic risk assessment practice in place

Effect:

Inadequate physical controls increases the risk of incorrect, invalid, and inappropriate use of inventory and inaccurate system inventory records.

**Recommendations**

Management should formally assign overall authority, and areas of responsibility, for the inventory management process. Ideally such assignment would be done through a corporate policy to clarify authority to direct the activities of the inventory management process across BUs, reporting lines and functions, as needed (repeated from finding 1).

[Redacted]

[Redacted]

[Redacted]

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/30/2018

The Warehouse & Inventory Operations Manager has authority over all parts room processes and will be clarified in the new Corporate Policy. Permitted employees who can access the parts rooms will be identified in the Policy (item #1).

[Redacted] how to record parts taken, and other related processes will be clarified in the Policy. A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment.

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Final Status		Medium
<p>Corporate Policy No. 2.1.15, Inventory Management, assigned overall authority for Inventory Management to Supply Chain and identified, by title, the employees authorized to access the parts rooms.</p> <p>[REDACTED]</p> <p>A risk assessment for Inventory management has not been performed. Management stated that a risk assessment was planned for January 2019.</p> <p>[REDACTED] a risk assessment for the Inventory Management process be performed.</p>		
Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/1/2019
<p>[REDACTED] An annual risk assessment will be conducted in January 2019.</p>		

## 6. Automated Reorder Process

Preliminary Finding R-17-13-6	Medium
<p>Criteria: Executive Limitations Policy No. 2.2.1 "Asset Protection," states, "Assets of the Utah Transit Authority shall not be unprotected, inadequately maintained, or unnecessarily risked. Accordingly, the General Manager shall not:</p> <ol style="list-style-type: none"> <li>1. Fail to protect against:               <ol style="list-style-type: none"> <li>a. Property and casualty losses;</li> <li>b. Public officials' errors and omissions and fiduciary liability;</li> <li>c. Theft and fraud;</li> <li>d. Loss of value, appearance, and utility of assets; and</li> <li>e. Loss of or significant damage to intellectual property, systems, and records essential to the well-being of the Authority."</li> </ol> </li> </ol> <p>Condition:</p> <ul style="list-style-type: none"> <li>• Inventory Control did not retain copies of the reports used to set reorder points and there is no review process in place to ensure its accuracy and completeness</li> </ul>	

# APPENDIX 1

- The root cause and corrective action was not indicated for 13 out of stocks that occurred since November 1, 2016. While less than 1 percent of all out-of-stocks during that period, IA noted there was no control in place to ensure that all out-of-stock transactions were researched
- Personnel for two locations were not included on the monthly inventory management meeting invitation

## Root/Cause Analysis:

- Reorder point reports were lost during the recent upgrade of the ERP system
- Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process

## Effect:

- Lack of an audit trail and review of the process increases the risk of error in automated reordering
- Increased risk of issues not being communicated and addressed for those locations without representation at monthly inventory management meetings

## Recommendations

Management should perform a periodic review to determine the accuracy and completeness of the reorder point report process and ensure reports are retained on file. Further, management should work with UTA legal counsel to establish records classification and retention schedules.

Management should consider creating an SOP that includes reorder point report periodic reviews and documentation retention requirements for all critical controls and reports.

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/30/2018

By the target date we will create a report to monitor OOS that do not have an RC/CA. We will also create a report that will identify repeat OOSs by part number over a period of time. We will review retention requirements with the Records Retention Manager for applicability.

## Final Status

**Low**

Inventory Management developed a report to monitor OOS inventory with no root cause (RC) or corrective action (CA), which was generated each Monday starting on June 11, 2018. The report was automatically emailed to the ERP Tech Sys Admin-Supply Chain and Materials and Inventory Controls Analysts. For each item listed, the Materials and Inventory Control Analysts performed research and then entered the appropriate RC and CA.

IA haphazardly selected the reports from July 9<sup>th</sup> and August 27<sup>th</sup>. Six inventory items were listed on the July 9<sup>th</sup> report but dropped off as Inventory Controls Analysts researched and entered the RC and CA information. The August 27<sup>th</sup> report had no inventory items listed. While the control appears to be operating effectively, IA recommends that the process be included in a standard operating procedure (SOP) that describes the process, indicates when the ERP Tech Sys Admin-Supply Chain should follow up with Inventory Controls Analysts, and how that follow-up should be documented.

# APPENDIX 1

IA found that overall trends in OOS inventory were being monitored using a monthly OOS Analysis report. IA noted that the report and OOS analysis process was being refined and had not been documented in a SOP, which IA recommends.

There was no Government Records Access and Management Act (GRAMA) classification or retention schedule in place for the OOS reports, resulting in an increased risk of not being in compliance with GRAMA. IA recommends that Inventory Management work with the Records Manager to classify all inventory management reports and records and ensure retention is in compliance with the statute.

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	Complete

The OOS RCCA report is generated weekly and items that are identified as not having an RCCA on the report are addressed by the Inventory Manager and the Inventory Analysts. These items remain on the report until an RCCA is entered. This process is rudimentary and not necessary to add to a departmental SOP. The OOS trends analysis is currently being done by reviewing RCCA information and currently doesn't justify creating a departmental SOP. It is too early in the analysis to understand if this analysis has cost benefits.

Separate inventory records retention is not necessary since inventory transactions can be researched and identified with time-stamps, who performed the transaction, what was transacted, and all other relevant information. This information is stored within the JDE system and does not expire.

## 7. Receiving of Inventory

Preliminary Finding R-17-13-7	Medium
<p>Criteria:</p> <p>Executive Limitations Policy No. 2.2.1 "Asset Protection," states, "Assets of the Utah Transit Authority shall not be unprotected, inadequately maintained, or unnecessarily risked. Accordingly, the General Manager shall not:</p> <ol style="list-style-type: none"> <li>1. Fail to protect against:               <ol style="list-style-type: none"> <li>a. Property and casualty losses;</li> <li>b. Public officials' errors and omissions and fiduciary liability;</li> <li>c. Theft and fraud;</li> <li>d. Loss of value, appearance, and utility of assets; and</li> <li>e. Loss of or significant damage to intellectual property, systems, and records essential to the well-being of the Authority."</li> </ol> </li> </ol> <p>Condition:</p> <ul style="list-style-type: none"> <li>• Parts rooms procedures regarding documentation of received inventory vary. Not all parts rooms retained packing slips. In addition, not all parts rooms required a signature and date for items reviewed against the packing slip</li> <li>• Evidence of the control to review packing slip entry into the ERP System was not retained (repeated condition from finding 2)</li> </ul>	

# APPENDIX 1

- There was no SOP or other documentation detailing steps to be taken when vendor disagreements arise
- 4 (out of 25) item receipts tested were entered into the ERP System on a date other than the date stamped by the receiving parts clerk, creating the risk that parts may be stocked prior to entry into JDE or parts may not be available when needed
- For 2 (out of 25) item receipts tested the date stamp was illegible due to poor scanning and/or insufficient ink from the original stamp, compromising the audit trail for parts in the event of vendor disputes or other anomalies
- Although the receiving warehouse clerk verified the number of boxes and total weight delivered by the shipper and signed to acknowledge receipt, shipments were not otherwise tracked. Receiving warehouse clerks did sign and retain all bills of lading, however, they did not maintain a log of shipments to agree with the signed bills of lading

## Root/Cause Analysis:

- Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process
- No formal, ongoing, and periodic risk assessment practice in place

## Effect:

Without adequate and effective controls, including sufficient SODs, there is an increased likelihood of inaccurate, incomplete, or invalid receipts.

## Recommendations

Management should create an SOP that includes directions for users that conforms to best practices for managing the receipt of inventory.

Management should include inventory receipt risk in a formalized, ongoing, and periodic risk assessment for inventory management.

	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/30/2018

Included in the new Corporate Policy (item #1) will be a policy that requires receiving divisions to sign, date and retain stock order packing slips. An email will be sent to all divisions requesting stamps to be legible. A log will be created to track all incoming shipments at the receiving docks. A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment.

## Final Status

**Low**

As noted in Finding 1, best practices recommend that policies set forth process objectives and roles and responsibilities. Procedures, on the other hand, should describe the steps required to ensure that process objectives set forth in policy are to be achieved.

Corporate Policy No. 2.1.15, Inventory Management, included a requirement for receiving divisions to sign, date, and retain stock order packing slips. Prior to the Policy's approval, the Warehouse and Inventory Operations Manager instructed parts and warehouse staff to implement the new packing slip procedures, which were defined in the policy.

# APPENDIX 1

IA noted that an SOP that conforms to best practices for managing the receipt of inventory was not created. IA recommends that Inventory Management create an SOP to guide users through the process, including critical controls and best practices for inventory receiving rather than relying on the Policy.

IA selected a sample of 16 packing slips for review and found that:

- 3 had not been initialed
- 7 had no indication of the date the items were received

IA recommends that staff be trained on best practices for compliance with the packing slip policy.

The Policy also included a requirement for Warehouse staff to log incoming shipments, which management asserted was implemented in July. IA haphazardly selected one location to review the log of incoming shipments and noted the following:

- There was no requirement for a unique identifier for each shipment log
- There was no requirement for bills of lading to be signed and dated

The lack of information recorded on the log and bills of lading may result in difficulty matching bills of lading to corresponding log entries. IA also noted that the Corporate Inventory Management Policy did not include a retention period for the receiving logs.

IA recommends that receiving logs be modified to include a unique identifier for each shipment and that receiving controls and best practices, including what information is needed to appropriately maintain a shipping log as well as where and how long those logs should be retained, be documented in an SOP. IA also recommends that bills of lading (BOL) be signed, dated, and retained and that the best practices and controls for that process be documented in an SOP.

There was no documentation file, such as an email, that indicated warehouse staff had been reminded to ensure stamp legibility, which IA recommends.

A risk assessment for Inventory management has not been performed, and IA recommends that a formal documented, periodic risk assessment be conducted. Management stated that a risk assessment was planned for January 2019.

Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/1/2019

All divisions have been instructed to sign and date all incoming packing slips, and to retain the packing slips for a period of one year. The receiving logs will be modified to include the last 5 digits of the BOL number as a unique identifier. In addition, an annual risk assessment will be conducted in January 2019.

Supply Chain will create an SOP to guide employees through the receiving process and employees will be trained with this document when it is approved. Part of this SOP will include instruction to ensure date stamps are legible on appropriate documents.

# APPENDIX 1

Inventory management provided direction in the policy to retain stock order packing slips for a period of one year, however it is up to the individual units to determine how to best perform that retention within their business.

Shipping best practices will be established and either added to the current policy or new procedures as dictated by the new UTA policy template.

## 8. Issuing Parts to Work Orders

Preliminary Finding R-17-13-8

Medium

Criteria:

Executive Limitations Policy No. 2.2.1 "Asset Protection," states, "Assets of the Utah Transit Authority shall not be unprotected, inadequately maintained, or unnecessarily risked." Accordingly, the General Manager shall not:

1. Fail to protect against:

- a. Property and casualty losses;
- b. Public officials' errors and omissions and fiduciary liability;
- c. Theft and fraud;
- d. Loss of value, appearance, and utility of assets; and
- e. Loss of or significant damage to intellectual property, systems, and records essential to the well-being of the Authority."

Condition:

- There was no SOP in place to guide users in appropriately accounting for parts taken directly by Maintenance personnel when parts room or warehouse staff were not available, or for how to enter those parts into the system after the fact.
- The manual logs for parts taken by Maintenance when inventory staff were not available were not retained or reviewed for accuracy and completeness (repeated condition from finding 2)
- There was no control in place for parts that were removed but not listed on the log (repeated condition from finding 2)
- There was no documentation of maintenance approval of parts issued to work orders (repeated condition from finding 2)

Root/Cause Analysis:

- Management relied on informal means of communicating areas of responsibilities rather than by documented corporate policy
- Management relied on the expertise of existing staff rather than a set of documented procedures to guide users in the process
- There was no formal, ongoing, and periodic risk assessment practice in place

Effect:

Without adequate and effective controls, as well as a sufficient SODs, there is an increased likelihood of inappropriate or invalid use of inventory and inaccurate records within the ERP System.

# APPENDIX 1

Recommendations		
<p>Management should create an SOP that includes requirements for users that conforms to best practices for inventory issued to work orders.</p> <p>Management should include the parts issuance process in a formalized, ongoing, and periodic risk assessment for inventory management.</p>		
Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/30/2018
<p>how to record parts taken, and other related processes will be clarified in the new Corporate Policy (item#1). Those affected will be re-trained in the process. A formal risk assessment for Inventory Management will be conducted annually in conjunction with, and feeding into the annual Supply Chain risk assessment.</p>		

Final Status	Medium	
<p>Corporate Policy No. 2.1.15, Inventory Management was approved on September 10, 2018.</p> <p>Because the Policy was not in force during the audit period, staff training on the new process was not in place and could not be tested. In addition, the Policy assigned responsibility for ensuring that the proper inventory was issued to each work order to Maintenance.</p> <p>A risk assessment for Inventory management has not been performed. Management stated that a risk assessment was planned for January 2019.</p> <p>In addition, IA recommends that management create an SOP that conforms to best practices for inventory issued to work orders, that staff receive training on Corporate Policy No. 2.1.15, and that a risk assessment be performed on Inventory Management.</p>		
Management Agreement	Owner	Target Completion Date
Yes	Sr Supply Chain Manager	6/1/2019

# APPENDIX 1

Per their own departmental practices, Maintenance is required to review each work order for parts and labor accuracy before closing each work order. A risk assessment is scheduled and will be performed annually.

# APPENDIX 2

## REPORT RATING MATRICES\*

### OVERALL REPORT RATING

The overall report ratings are defined as follows, applicable to the audit scope as defined

<b>Descriptor</b>	<b>Guide</b>
<b>Fully effective</b>	Controls are as good as realistically possible, both well-designed and operating as well as they can be.
<b>Substantially effective</b>	Controls are generally well designed and operating well but some improvement is possible in their design or operation.
<b>Partially effective</b>	Controls are well designed but are not operating that well. OR While the operation is diligent, it is clear that better controls could be devised.
<b>Largely ineffective</b>	There are significant gaps in the design or in the effective operation of controls – more could be done.
<b>Totally ineffective</b>	Virtually no credible controls relative to what could be done.

### DETAILED FINDING PRIORITY RATING

<b>Descriptor</b>	<b>Guide</b>
<b>High</b>	Matters considered being fundamental to the maintenance of internal control or good corporate governance. These matters should be subject to agreed remedial action within three months.
<b>Medium</b>	Matters considered being important to the maintenance of internal control or good corporate governance. These matters should be subject to agreed remedial action within six months.
<b>Low</b>	Matters considered being of minor importance to the maintenance of internal control or good corporate governance or that represents an opportunity for improving the efficiency of existing processes. These matters should be subject to agreed remedial action and further evaluation within twelve months.
<b>Implemented</b>	Management action has been taken to address the risk(s) noted in the audit finding.

# APPENDIX 3

DISTRIBUTION LIST			
Name	For Action <sup>1</sup>	For Information	Reviewed prior to release
Interim Executive Director			*
Managing Attorney		*	
VP of Finance	*		*
Sr Supply Chain Manager	*		*
ERP Tech Sys Admin-Supply Chain	*		*
Warehouse & Inv Ops Mgr	*		*

<sup>1</sup>For Action indicates that a person is responsible, either directly or indirectly depending on their role in the process, for addressing an audit finding.