FACILITIES MANAGEMENT

CENTRAL WAREHOUSE INVENTORY REVIEW

AUDIT REPORT #20-2001

Audit & Advisory Services

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# Background

In accordance with the UCLA Administration fiscal year 2019-20 audit plan, Audit & Advisory Services (A&AS) performed an audit of controls and procedures associated with central warehouse operations that are administered by the Finance, Space & Logistics division within the Facilities Management (FM) department.

The Central Warehouse supports various FM departmental units through the provision of a centralized requisition process for required materiel and equipment, and is managed by Materiel Management staff. Its mission is to provide a range of services that result in reduced material and labor charges to campus clients. The Central Warehouse is located in the FM Building, which is adjacent to the Cogeneration Plant and UCLA Police Department. Materiel Management also operates one satellite storage area that is located in the Center for Health Sciences (CHS) complex.

Materiel Management has replaced the more traditional procurement emphasis on order processing with a more proactive approach that forecasts and plans for material needs and establishes inventory policies and procedures. The new approach has improved material availability and reduced obsolete and excess material, resulting in fewer shortages and better client response and efficiency. Materiel Management uses a centralized, automated Maintenance, Repair, and Operating supplies warehouse and bar code technology to track materials to make maximum use of existing, and reduce overall, departmental inventory. The system provides increased accuracy in billing, inventory costing, and quantity on hand data to increase negotiating position while monitoring vendor performance.

The central Tool Crib merged with the Central Warehouse in April 2019. As a result, Central Warehouse operations now include maintaining the inventory of tools and equipment for utilization by skilled and semi-skilled trades people who are responsible for maintaining University building systems and infrastructure of occupied building space on the campus and in the Medical Center. With the merger, the tools and equipment were physically relocated, became part of the Central Warehouse inventory, and the records were fully transitioned from CribMaster to Maximo, the software system used to manage the inventory for the department.

Staffing for the main warehouse and satellite locations consists of seven employees, headed by a Warehouse and Materiel Manager (Warehouse Manager).

# Purpose and Scope

The primary purpose of the review was to ensure that Finance, Space & Logistics’ organizational structure and controls related to the central warehouse are conducive to accomplishing its business objectives. Where applicable, compliance with campus and University policies and procedures was also reviewed.

The scope of the engagement included the following areas:

* Physical Security
* Inventory Practices
* System Access Controls
* Receiving
* Issuance
* Separation of Duties

The review was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing* and included interviews, tests of records, and other procedures considered necessary to achieve the audit purpose.

# Summary Opinion

Unfortunately, the coronavirus disease 2019 (COVID-19) pandemic has resulted in reduced staffing levels for FM and a shift in their priorities to focus on essential services. COVID-19 has also affected A&AS’ ability to perform certain audit procedures as a part of this engagement. Typically, A&AS would obtain documentation and perform interviews to audit the scoped areas; however, because of FM’s shift in priorities and reduced staffing levels, the necessary information could not be provided for audit review. This limited the scope of the audit and A&AS’ ability to provide an evaluation of the adequacy and effectiveness of internal controls over the scoped areas.

A portion of the Inventory Practices area within the audit scope was performed remotely and the scope was not significantly impacted by COVID-19. Internal controls over this area were generally adequate and effective. However, management could further strengthen controls by implementing the following:

Inventory Practices

* Management should develop procedures to ensure that inventory adjustments have the signed approval of an authorized person, and that large adjustments are documented with an explanation.

The audit results and corresponding recommendation are detailed in the following sections of the report.

# Audit Results and Recommendations

## Physical Security

A&AS conducted a tour of the main Central Warehouse inventory storage area at the FM Building and interviews were performed to determine whether physical security controls over the managed inventory are adequate.

### Inventory Security Arrangements

The Central Warehouse has 13 surveillance cameras located at the FM Building and three cameras at each remote drop-off site where materials and equipment are delivered. The camera footage from all locations is recorded to a physical server stationed within the FM Building and stored for 30 days. Only key management personnel have access to the recorded footage.

Based on discussions held with the Security & Fire Alarms Supervisor, it appears that surveillance camera security arrangements throughout the main Central Warehouse area and drop-off sites are adequate. However, the CHS satellite storage location staffed by one Materiel Management Stores Worker does not have surveillance cameras installed, and A&AS was not made aware of any departmental plans for surveillance camera installations in the future. Safeguards to protect the inventory include physical counts that are conducted annually, but a perpetual inventory system is not utilized at the satellite storage location, which limits management’s ability to track and control the inventory.

A&AS noted the issues of no surveillance cameras and the choice to not utilize a perpetual inventory system at its satellite location in our 2007 audit. Facilities Management has determined that it will accept the risk of potential loss in the satellite location by relying on existing controls. Based on data obtained during the previous audit in fiscal year 2014-15, the average CHS inventory valuation at year end was $350,691. Similar information was not available for A&AS to review during the current audit.

According to the Maintenance & Alterations (M&A) Director, the M&A division owns the inventory, Materiel Management provides the staff to manage the inventory, and CHS owns the space. A&AS attempted to obtain documentation reflecting current inventory valuations for each storage location and to further discuss inventory security arrangements with management. However, because of the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether security arrangements used to safeguard inventory against loss through damage, theft, or misappropriation are adequately proportional to its value and potential for removal from the site.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

### Key Access

The Warehouse Manager is responsible for managing the keys that provide access to the inventory storage areas. The manager, who is the only person authorized to order keys from the FM Hardware Shop, controls the key issuance process and maintains a record of the distributed keys. The lockbox where keys are stored is located in the Warehouse Manager’s office. An additional key is stored and managed by the Trouble Call Center for after-hours access.

The number of keys issued for each inventory storage location was obtained from the FM Hardware Shop to reconcile the information with the records maintained by the Central Warehouse. Based on FM Hardware Shop records, it appears that six keys that were provided to the Warehouse Manager in 2010 for the North Zone Utility satellite storage area located in the Public Policy building are still active. This location, however, has not been used to store inventory for years, according to the Warehouse Manager.

A&AS attempted to obtain management’s records of employees with key access and to discuss key access controls. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether access to the inventory is adequate and appropriate.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

## Inventory Practices

Management utilizes the data in Maximo to maintain control over the inventory, and to help ensure that material and equipment needs are met. Physical inventory counts are performed annually to verify that the records in Maximo accurately reflect the quantity on hand. Any variances discovered in the process are researched and records are adjusted to reflect actual inventory figures. Reorder points and other inventory levels are also adjusted annually based on reports generated from Maximo data.

### Inventory Level Optimization

Central Warehouse inventory levels are optimized based on item usage and available storage space. Various reports generated via Maximo help management analyze inventory usage and determine whether use patterns qualify the items for continued retention. For example, certain reports are analyzed annually to set the reorder point and economic order quantities for items. The Daily Inventory Issues reports are generated to keep track of items issued each day. In addition, a reorder function in Maximo is used to determine inventory levels when necessary. The function allows the user to pull a category of items and place orders based on stock levels. The Warehouse Manager is the only person who can modify reorder points. Lastly, the Materiel Management staff working at the Central Warehouse can visually scan the storage areas and determine which items need to be re-stocked.

The Materiel Management Stores Worker at the CHS satellite storage area ensures that the inventory is re-stocked every time the items are issued. Because a perpetual inventory system is not utilized for the items at the satellite location, inventories are not regularly reviewed by Materiel Management staff to assure that the use pattern qualifies the item for continued retention. Unless directed otherwise by M&A, the inventory is automatically replenished with the same number of items that were issued.

Based on discussions held with management, it appears that controls are in place to optimize inventory levels at the main Central Warehouse area. A&AS attempted to obtain copies or samples of the Reorder Point, Economic Order Quantity, and Daily Issues report. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to verify whether the reports are generated and reviewed to assist management to optimize inventory levels.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

### Inventory Count

Interviews were held with the Warehouse Manager to discuss whether inventory counts are performed. Based on the discussions, it appears that physical inventory counts are conducted annually by an outside vendor and reviewed by management. A&AS attempted to obtain documentation reflecting the latest inventory counts. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the requested records to verify whether the most recent physical inventory counts were conducted as described to the audit team.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

### Variances

Discussions were held with Central Warehouse management, standard operating procedures were reviewed, and documents were requested to verify whether inventory variances were researched, properly approved, and documented.

After the first physical inventory count is performed, the Warehouse Manager generates several reports to detect discrepancies between the physical count and the records in Maximo. Items with a variance greater than $1,000 are identified and counted again. Any corrections are made before running the report a second time to identify items with variances greater than $200. After counting and correcting any items greater than $200, the final report is generated, and correct counts are updated in Maximo.

Once the physical inventory is complete, the Warehouse Manager performs a review of the variances. For example, similar items that are stored next to each other are checked frequently. After further investigation, corrections are updated in Maximo. Because a perpetual inventory system is not utilized for the items at the CHS satellite storage area, inventory variance reports are not generated and reconciliations are not performed for those satellite items.

Based on discussions with management, it appears that variances are researched for the Central Warehouse inventory at the FM Building. A&AS attempted to obtain documentation reflecting the variances and actions taken to investigate the cause of any significant variances. A&AS also attempted to discuss the controls in place to detect inventory loss at satellite locations. Due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the necessary information to properly evaluate the controls in this area. However, initial discussions with management disclosed that reviews performed to investigate variances that exceed acceptable tolerances are not documented. According to UC Policy Business and Finance Bulletin BUS-54, “Operating Guidelines for University Supply Inventories,” “stock adjustments are to have the signed approval of the Materiel Manager or designee who must not be the individual responsible for the inventory. Large adjustments shall be supported by an explanation.” Documenting reviews of large inventory variances is important to maintain an adequate audit trail, and may help detect reoccurring issues resulting in loss through damage, theft, or misappropriation.

Recommendation: Management should develop procedures to ensure that inventory adjustments have the signed approval of an authorized person, and that large adjustments are documented with an explanation.

Response: Facilities Management concurs that inventory adjustments should have the approval of an authorized person and that large inventory variances are important and should be supported by documentation.

## System Access Controls

Maximo and FM Mobile are used to manage the perpetual inventory for the Central Warehouse. FM Mobile, which is integrated with Maximo, was introduced in June 2019. Through the enhanced mobile handheld technology, inventory is received, counted, issued, and drop-delivered to campus locations, and communications are improved.

A&AS attempted to obtain a list of Maximo users with access to Central Warehouse inventory functions and to discuss user access management. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether the process for granting and removing access to the inventory management system is adequate. Furthermore, A&AS could not verify whether current access to the inventory management system is limited to authorized personnel, and that privileged access is properly assigned based on job functions.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

## Receiving

Orders from vendors that are addressed to the Central Warehouse are delivered to FM’s Receiving area. Employees from the Receiving area sign for the delivery, create a copy of the packing slip, and deliver the package and documentation to the Central Warehouse. The items received are manually counted, compared with packing slip documents, and examined by Materiel Management employees before placing the items into inventory stock.

Based on preliminary survey discussions held with management, it appears that the inventory receiving process is adequate. A&AS attempted to obtain the updated receiving standard operating procedures that incorporate FM Mobile and to further discuss the controls over the receiving process. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether the receiving process is adequate.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

## Issuance

There are currently two methods for issuing the inventory. The first method is a new delivery system that was created to streamline the issuance of materials and equipment. Instead of having skilled craft employees travel between job sites and the Central Warehouse, campus clients can now order items and have them delivered to the field several times a day. When the order is received, the Materiel Management personnel obtain the requested items from the warehouse and send them out to the designated drop-off points through couriers. Unused materials and equipment are picked up by the couriers at the same drop-off points.

The older method, which has not changed significantly since the prior audit, is still used for emergencies and after normal business hours. Skilled craft employees travel to the Central Warehouse, pick up the items from the shelves, and complete and submit a Material Pull Form. The employees can also drop-off unused material and equipment at the Warehouse. FM skilled crafts employees can check out the Central Warehouse key from the Trouble Call desk after normal business hours, which are on weekends and between the hours of 2:00 a.m. and 6:30 a.m. on weekdays.

Preliminary survey discussions were held with management to obtain an overview of the inventory distribution process. A&AS attempted to obtain the updated standard operating procedures that incorporate FM Mobile and to discuss the controls in place to issue and deliver items. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether procedures and business practices for distributing inventory are adequate, items are only issued to authorized employees, and that tools and equipment are returned timely after their use.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

## Separation of Duties

A&AS attempted to hold discussions regarding the separation of duties over inventory operations. However, due to the limitation caused by the COVID-19 pandemic, A&AS did not receive the information necessary to determine whether a reasonable separation of duties exists over inventory activities and processes.

Subject to the limited scope of audit work that could be completed, as described earlier, there were no significant control weaknesses noted in this area.

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