

**CITY OF HAMILTON
INTERNAL AUDIT REPORT 2013-17
PUBLIC WORKS – TRAFFIC INVENTORY
FOLLOW UP**

OBSERVATIONS OF EXISTING SYSTEM	RECOMMENDATION FOR STRENGTHENING SYSTEM	MANAGEMENT ACTION PLAN	FOLLOW UP (DECEMBER 2015)	FOLLOW UP (JULY 2020)
<p>Inventory Management</p> <p>Traffic Operations have a stockroom containing the parts and materials needed by staff. The parts and materials removed from stock by staff are not tracked by the Inventory Clerks. Therefore, it is not possible to reconcile the parts and materials obtained from the stockroom to the parts and materials reported as having been used on the Daily Activity Sheets (DAS) that are completed by staff. These daily records are used to maintain the inventory records in Hansen.</p>	<p>1. That Traffic Operations management develop a system to track parts and materials taken from the stockroom by staff in order that accurate inventory records are maintained.</p>	<p>Agreed. Traffic will develop revised practices and procedures to ensure the inventory is tracked through streamlined processes to ensure the inventory records are accurately maintained.</p> <p>Improvements in parts and materials tracking will require segregation of inventory in a closed off stock room to limit access to inventory. Some additional construction costs will be required to segregate the stock room.</p> <p>The timeline for completion of the recommendation is December 2015.</p>	<p>In Progress.</p> <p>Management has re-organized the inventory and limited access to the stockroom to an appropriate number of staff.</p> <p>A draft procedure has been developed to track the movement of parts and materials from the stockroom. This procedure is expected to be finalized and implemented by March 2016.</p>	<p>Initiated. Although stockroom access is restricted and staff track the movement of stockroom inventory, it is still difficult to reconcile items obtained from the stockroom to those reported as having been used on DAS. Also, no system is in place to track materials taken from secondary inventory. Management should continue to develop their inventory tracking processes to help facilitate reconciliation of inventory signed out and used by staff.</p> <p>The draft procedure developed in December 2015 remains in draft form and does not address the issue observed in the original audit.</p>

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<p>Parts and Materials Orders</p> <p>A minimum re-order quantity has not been set for any of the parts and materials in inventory. Management has stated that, generally, three months' worth of supplies is maintained. The Inventory Clerks rely on physical observation and experience to gauge re-order timing.</p> <p>However, due to the large number of parts and materials in the stockroom, the risk exists that some needed parts and materials could run too low before the shortage would be noticed. This could delay some of the work performed by Traffic Operations.</p>	<p>2. That management set minimum re-order quantities for the frequently used parts and materials deemed critical to Traffic Operations.</p> <p>3. That the Inventory Clerks re-order parts and materials using the minimum re-order quantity levels set above.</p>	<p>Agreed. Traffic Staff have already commenced the implementation of the minimum re-order quantities for all parts.</p> <p>Agreed. Inventory Clerks will re-order parts and materials using the minimum re-order quantity levels established in the Hansen system.</p> <p>The implementation of the minimum re-order point will commence no later than September 2014.</p>	<p>Completed. Management has developed procedures to calculate the re-order point for parts and materials. The minimum re-order quantities have been calculated for all materials and parts.</p> <p>Completed. Management began to use the minimum re-order quantities to place orders in December 2015.</p>	<p>In Progress. Minimum re-order quantities are assigned to various inventory items. However, there is no indication that management reviewed or adjusted minimum re-order quantities since December 2015.</p> <p>Not Completed. Traffic Operations Clerks use experience and visual inspection to re-order inventory because minimum re-order quantities were not meeting operational needs.</p>

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<p>Parts and Materials - Segregation of Duties</p> <p>The Inventory Clerk that orders the parts and materials also takes receipt of the order, places it in stock and records it in Hansen. The current process and poor segregation of duties does not mitigate the risk of fraudulent activity.</p>	<p>4. That the Inventory Clerk that places and receives an inventory order be different from the Clerk responsible for stocking and recording the delivery in Hansen.</p>	<p>Agreed. Traffic is working in conjunction with the Finance group to change the workflow system to establish a more defined segregation of duties.</p> <p>This process will be completed by December 2014.</p>	<p>In Progress. Draft procedures have been developed with Clerk Dispatchers placing orders for parts and materials, while the Inventory Clerks will stock and record deliveries in Hansen.</p> <p>Procedures need to be finalized and approved. Expected Completion: March 2016.</p>	<p>Alternative Initiated.</p> <p>The Clerk Dispatcher and Inventory Clerk positions have been combined into a Traffic Operations Clerk. It is possible that the same Clerk may order goods, take receipt of the order, place the goods in stock and record the transaction in Hansen. Although a peer review process has been implemented to ensure the accuracy of Hansen transactions, the risk of misappropriation remains as staff can adjust Hansen inventory quantities or falsify inventory count results. Therefore, additional controls around inventory adjustments and count procedures must be implemented to mitigate the risk associated with inadequate segregation of duties.</p>

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<p>Inventory Manufactured In-House</p> <p>The type and quantity of the materials obtained from the stockroom for the in-house manufacture of signs are recorded on a form called the Material Transfer Sheet. The quantities actually used when manufacturing the signs are tracked on a DAS. The amount transferred from the stockroom typically exceeds the amount actually used.</p> <p>Management does not monitor this difference in quantities. The risk is that material may be wasted or the excess misappropriated.</p>	<p>5. That management perform periodic reviews to compare the quantities of materials transferred from the stockroom to the in-house sign shop and the quantities of materials tracked on the DAS. Evidence of such reviews should be maintained.</p>	<p>Agreed. Traffic Operations has commenced a review of our current practices for the consumption of materials used in in-house manufacturing in order to accurately track materials.</p>	<p>Not Completed. Sufficient time has not elapsed since the stockroom was re-organized to review and compare the quantity of material transferred from the stockroom to the quantity of material tracked on the DAS. Expected Completion: February 2016.</p>	<p>Not Completed. Staff in the sign shop have access to raw materials in the stockroom to manufacture signs. Management has not performed reasonableness analyses to assess whether raw materials are being used in an efficient manner for intended purposes.</p>

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<p>Inventory Manufactured In-House (Cont'd) A table that is used to calculate the total cost (including labour, materials and overhead) of various traffic signs that are manufactured in-house has been developed and used to value signs inventory. This table has not been updated since January 2009. Costs have increased over the past five years but are not reflected in the table, resulting in undervaluation of in-house manufactured signs.</p>	<p>6. That Traffic Operations management annually update the table used in costing signs manufactured in-house.</p>	<p>Agreed. Traffic Operations management will update costs on an annual basis beginning in 2014. This process will be completed by December 2014.</p>	<p>Not Completed. Management has not updated the table used for costing signs manufactured in-house. Expected Completion: February 2016.</p>	<p>In Progress. The table used to cost in-house manufactured signs was last updated in May 2020. However, the Traffic Operations Clerks were unaware that this table was updated. The Clerks continue to use an outdated, printed price list to cost signs manufactured in-house.</p>

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<p>Stock – Year-end Inventory</p> <p>Periodic cycle counts have not been performed on fast moving or high value parts and materials as required by internal procedures. Cycle counts can reduce the effort required during the year-end inventory count and identify discrepancies earlier in the year.</p>	<p>7. That management perform cycle counts as required by the internal procedures.</p>	<p>Agreed. Upon the completion of item #1 – Inventory Management (December 2015), cycle counts as required by internal procedures will commence.</p>	<p>Not Completed. Cycle counts have not been performed. Management expects to begin performing cycle counts by June 2016.</p>	<p>Not Completed. There is no strategy as to which items are counted. Although management expects cycle counts to occur weekly, counts from July 2019-May 2020 occurred on a sporadic basis.</p>

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<p>Physical Inventory Count</p> <p>A physical inventory count is conducted in order to verify the existence of inventory items and adjust corresponding records to match the subsequent valuation of those items.</p> <p>A physical inventory count was conducted in November 2013. The count information gathered was manually loaded into a spreadsheet and valued. Comparison of data with records maintained in Hansen originally produced a variance of almost \$127,000 worth of inventory (representing 6.8% of the total Traffic inventory). Further investigation by staff provided instances of errors made in the physical count and in the Hansen records, reducing the variance to approximately \$102,000.</p>	<p>8. That physical inventory taking instructions be reinforced with individuals conducting the counts. Management should ensure the accuracy and completeness of the counts by spot checking count information to/from the item in inventory.</p>	<p>Upon the implementation of Item #1 – Inventory Management (December 2015), the physical inventory count process and cycle count process will be revised to ensure accuracy and completeness of the counts.</p>	<p>In Progress. Management re-organized the stockroom in the summer of 2015. The stations where the items are inventoried in the stockroom identify the parts and materials with a part number and picture.</p> <p>This will facilitate training the staff taking inventory in December 2015. It will also make it easier when spot checking for accuracy/ completeness.</p> <p>Expected Completion: December 2015.</p>	<p>Not Completed. Staff counting inventory in June 2020 were provided insufficient instructions and training on how to count inventory. No comprehensive work instructions exist to assist counters and those responsible for supervising the count. Both management and the OCA identified several issues and errors, calling into question the accuracy and completeness of the count.</p>

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<p>Physical Inventory Count (Cont'd)</p> <p>Year-end valuation in Hansen produced another value for the inventory and the general ledger was adjusted to match, resulting in a final variance of over \$111,000 (5.5%) from the original updated physical count. Management has indicated that variances of 5% are acceptable.</p> <p>The effectiveness of a physical count as a sound inventory control is lost when the inventory records are not adjusted to the actual count. Differences are carried forward year over year without resolution.</p>	<p>9. That Hansen records be adjusted to match the physical count details as at the time of the count.</p>	<p>Agreed. Hansen records will be adjusted to match the physical count details as at the time of count. This process will be completed by December 2015.</p>	<p>Not Completed. The December 2015 inventory will be the first one with the newly re-organized stockroom. Adjustments to Hansen records are expected to be made after the 2015 inventory is taken.</p> <p>Expected Completion: February 2016.</p>	<p>Not Completed. Hansen inventory records were not adjusted for the June 2020 count. The OCA was unable to locate all the count documents for the 2019 year-end count; therefore, it is unclear whether adjusting entries were complete or accurate.</p>