

TTC AUDIT COMMITTEE REPORT NO. 3(h)

MEETING DATE: May 12, 2014

SUBJECT: TTC AUDIT REPORT – AUDIT OF CYCLE COUNTS AND
DIVISIONAL STORES CONTROL – CORPORATE SERVICES
GROUP, MATERIALS AND PROCUREMENT DEPARTMENT,
MATERIALS MANAGEMENT SECTION

INFORMATION ITEM:

RECOMMENDATION

It is recommended that the TTC Audit Committee receive for information the attached TTC Audit Report.

01-27



TORONTO TRANSIT COMMISSION

AUDIT OF CYCLE COUNTS AND DIVISIONAL STORES CONTROL

CORPORATE SERVICES GROUP MATERIALS AND PROCUREMENT DEPARTMENT MATERIALS MANAGEMENT SECTION

Covering Period:
January 2012 to March 2013

TTC AUDIT DEPARTMENT
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FILE NO. 13-30000-03

SEPTEMBER 2013

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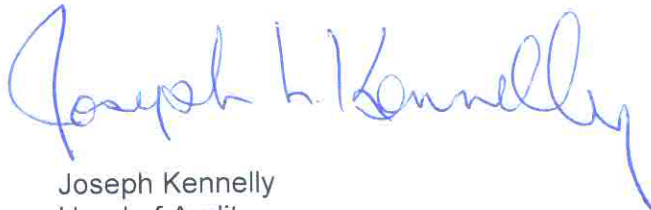
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EXECUTIVE SUMMARY

An audit to assess the procedures and controls over inventory cycle counts and the security and controls over inventory stored at the Central Stores and Distributed Stores locations of the Materials Management Section has been completed. An Exit Meeting was held on February 6, 2014 with the Chief – Financial and Administration Officer, the Head of the Materials and Procurement Department and the Director – Materials Management Section to discuss the results of the audit.

The audit tests indicated that the processes and controls over the cycle and strip counts, materials stored at the divisional stores and inventory information are operating as expected and no significant weaknesses were noted. However, no investigation is performed to determine the actual causes of cycle count discrepancies and no supervisory approval of adjustments for strip count discrepancies is required. We also noted that not all divisional stores during some shifts are staffed by stores' personnel and access to inventory materials during those times are not restricted. These deficiencies have been brought to Management's attention and audit recommendations were made to improve the situation. There was agreement on the audit findings and recommendations and actions have been taken to address the deficiencies noted.

We wish to express our thanks to the staff of the Materials Management Section for their cooperation and assistance during the course of this audit.



Joseph Kennelly
Head of Audit



Dante Torralba
Audit Manager

BACKGROUND

The Materials Management section of the Materials and Procurement (M&P) Department monitors TTC's inventory for bus, subway, streetcar and building material and provides support to ensure material and inventory needs are met. The inventory carrying value as at the end of December 2012 was \$107.8 million. Within the Materials Management section, the Central Inventory Control and Distributed Inventory Control areas are responsible for the warehousing, issuance and receipt of the TTC's inventory at four main warehouses, three shops and 22 divisional stores. The Inventory Module of the Inventory Computer Application (IFS) is used to manage inventory and record inventory transactions.

To ensure the accuracy of recorded quantities and balances, the staff conducts cycle counts and strip counts of inventory stored at the warehouses, shops and divisional stores. In cycle counts, IFS generates a daily list of inventory items selected based on preset parameters (e.g., frequency of use) for counting. The parameters have been set to ensure that all inventory items are counted at least once in the year. In addition, strip counts conducted at the Distributed Stores involves the counting of each inventory carried at each location once every month. Discrepancies between the actual physical counts and recorded quantities are investigated and the inventory records are adjusted to reflect the actual quantities on-hand.

AUDIT SCOPE AND OBJECTIVES

Scope: The audit scope included an assessment of the procedures and controls over inventory counts conducted at the central stores and divisional stores locations, and the security over inventory stored at all stores locations.

The review covered the period from January 2012 to March 2013.

Objectives: To assess the management and operational controls to ensure:

- the adequacy and effectiveness of the controls over the inventory cycle and strip counts and the controls over inventory stored at the divisional stores locations
- controls are operating as expected, and information maintained is accurate, complete and available when needed
- control weaknesses or deficiencies are identified and addressed and recommendations are implemented to improve the processes

AUDIT METHODOLOGY

To achieve the audit objectives, existing procedures and controls over inventory cycle counts and strip counts were reviewed. Audit attended and observed cycle counts at all Central Stores locations and at randomly selected Distributed Stores locations. Observations of strip counts were also conducted at the selected Distributed Stores locations. Audit tests were conducted to verify the propriety of the recording of count results. Audit also reviewed procedures and controls over the issuance and receipt of materials and the subsequent recording of these transactions at selected Distributed Stores locations, as well as the security measures to protect inventory stored at the selected locations.

The results of the review were discussed with the Director – Materials Management and the Managers of the Central Inventory Control and Distributed Inventory Control sections.

CONCLUSION

Processes and controls over inventory cycle and strip counts, and inventory materials stored at the divisional stores were found effective and operating as expected. Inventory information maintained was complete and available when needed.

However, Audit noted that adjustments for cycle count discrepancies are not investigated to determine the actual causes for the discrepancies, and no supervisory approval is required resulting from adjustments for discrepancies noted during strip counts.

ANALYSIS AND RECOMMENDATIONS

FINDING #1

CYCLE COUNTS AND STRIP COUNTS

OBJECTIVE: To assess the adequacy and effectiveness of the cycle count processes and controls in ensuring that all inventory items are counted at the required frequency, and adjustments to the recorded inventory value are properly supported.

ANALYSIS: In their management letter, TTC's external auditors, PricewaterhouseCoopers (PwC) indicated that there were numerous inventory items that were only counted once every three years in the inventory cycle count process. As a result, the inventory balance could be misstated as large inventory "book to physical" differences might exist for these items due to theft or human error in processing inventory and these differences would not be identified until the inventory items were counted. PwC had recommended that all inventory items, regardless of how they are used, should be counted at a minimum once per year. In turn, Management responded that the inventory counting processes had been changed such that all parts at all locations are now required to be counted at least once a year with certain high value items being counted to a maximum of four times per year.

Cycle counts are conducted at the Central Stores and Distributed Stores locations to ensure the accuracy of recorded inventory quantities and values. The frequency of these counts is based on the inventory values as well as frequency of use. Differences noted that exceed set tolerance limits are flagged by the inventory computer application (IFS) and require supervisory review and approval before any adjustments are recorded on IFS. In addition, the Inventory Planning section conducts independent counts of inventory items.

The results of audit tests performed showed no significant control weakness in the cycle count processes. Counts are conducted at the required frequencies and that inventory items are counted at least once a year. Audit did note the while adjustments require supervisory review and approval, no investigation is performed to determine the reasons, e.g., fraud, theft, causing the discrepancies. In addition to the cycle counts, daily strip counts are conducted in all divisional stores locations where all items in the stores are counted on a monthly cycle and adjustments for the differences recorded. Inventory balances are adjusted for the differences noted by completing and recording a Materials Requisition Slip. Audit found that no supervisory review or approval is required on these Materials Requisition Slips prior to recording the adjustments.

RECOMMENDATION: While cycle counts and strip counts contribute to ensuring the accuracy of recorded quantities and balances, the lack of review and investigation into the reasons for the discrepancies and the lack of approval of adjustments for strip count differences do not ensure that reasons for the discrepancies are identified and corrective action taken.

Audit recommends that significant discrepancies detected from cycle counts and strip counts are reviewed and investigated, and the adjustments be approved prior to recording.

**MANAGEMENT
RESPONSE:**

We concur with Audit that "Audit recommends that significant discrepancies detected from Cycle Counts and Strip Counts are reviewed and investigated and the adjustments approved prior to recording." The Count Results procedure #6.2.1 covers the Senior Storeperson and the Supervisors responsibility regarding the process of investigation before approving any count or strip discrepancies. We will be implementing the same process used for Cycle Counts with the Strip Counts to ensure consistencies as it relates to significant discrepancies. When Strip Counts are performed and discrepancies are identified the storepersons will advise the Supervisor and they must review, investigate and approve prior to the transaction being recorded. This can be accomplished as directed via email from the Supervisor to the Storeperson. We have updated the Strip Count procedure #6.3.1 in the Operating Procedures Manual.

We are currently working on a Pilot project to close the stockroom doors that will allow for better asset control and provide better customer service to the end users. This pilot will improve accuracy of inventory, provide personal customer service to the end user and maintain a steady supply of part which will reduce vehicles out of service.

Responsibility: Director – Materials Management

Completion Date: Not applicable

Status: Complete

FINDING #2

DIVISIONAL STORES CONTROLS

OBJECTIVE: To assess the adequacy and effectiveness of the controls in ensuring the protection and safeguarding of inventory stored at Divisional Stores locations and accuracy of the records maintained for these items.

ANALYSIS: During four shifts of the week, the divisional stores at the large bus and subway locations are not staffed by stores personnel. However, other locations, are staffed according to operating requirements of those locations.

During the hours when no stores personnel are on duty, Operations personnel are allowed access to stores areas to take out materials needed to complete jobs. Though employees are required to complete Materials Requisition Slips for the items taken from the stores, the required slips are not always prepared. The discrepancies noted during cycle counts and strip counts are recorded as materials issues to account for the undocumented issues thus adjusting the book balances to actual quantities.

The lack of stores staff coverage during shifts were noted and reported to Management in previous audits. Management had advised that the costs of the hiring additional personnel to cover those shifts outweigh the benefits from having increased coverage.

RECOMMENDATION: Recommendations for supervisory reviews and investigations of Cycle Counts and Strip Counts discrepancies and approval of the resulting adjustments as discussed in Finding #1 are reiterated.

MANAGEMENT RESPONSE: See Management Response under Finding #1 Recommendations.