AUDITOR-CONTROLLER/RECORDER
TREASURER/TAX COLLECTOR
COUNTY CLERK

COUNTY OF SAN BERNARDINO

Reply to:

AUDITOR-CONTROLLER • 222 West Hospitality Lane, Fourth Floor
San Bernardino, CA 92415-0018 • (909) 387-8322 • Fax (909) 386-8830 X

RECORDER • COUNTY CLERK • 222 West Hospitality Lane, First Floor
San Bernardino, CA 92415-0022 • (909) 387-8306 • Fax (909) 386-8940

TREASURER/TAX COLLECTOR • 172 West Third Street, First Floor
San Bernardino, CA 92415-0360 • (909) 387-8308 • Fax (909) 387-6716

LARRY WALKER
Auditor-Controller/Recorder
Treasurer/Tax Collector
County Clerk

May 24, 2010

Damian Parsons, Finance Officer
Information Services Department
670 E. Gilbert Street
San Bernardino, CA 92415-0915

SUBJECT: TELEPHONE SERVICES INVENTORY AUDIT FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Introductory Remarks

In accordance with the Auditor-Controller/Recorder/Treasurer/Tax Collector's Year-End Closing Manual, Information Services Department personnel conducted an inventory of their storerooms. We observed the storerooms' inventory on June 26, 2009.

Scope of the Audit

We audited the inventory procedures and controls in effect over the June 26, 2009 Information Services Department's (Department) inventory. Our audit was made in accordance with generally accepted auditing standards and included such tests of the records and other audit procedures we considered necessary in the circumstances. The audit work performed during the audit would not necessarily disclose all deficiencies in the system of internal controls.

Audit Results

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements in a timely manner. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified the following deficiencies in internal control that we consider to be significant deficiencies.

Significant Deficiency No. 1: Inventory procedures could be improved and inventory records could be more adequately maintained.

a. Inventory procedures could be improved. Presently, there are no procedures in place for the following:

Performing Physical Count
Determining and Handling Obsolete Inventory

b. Based on testing performed, perpetual inventory records did not always tie to actual inventory on hand. Specifically, 5% of the quantities on the perpetual inventory records tested did not agree with the actual inventory on hand. Updating of inventory records was not consistent.

Adequate policies and procedures and training are essential business tools in handling and accounting for inventory items consistently and effectively. Due to the small staff and low turnover rate, telephone services inventory procedures have been based on knowledge and prior inventory work experience. If staff has any questions on how to handle something, verbal instructions are provided by the Warehouse Supervisor. Also, inadequate training and lack of a user manual has contributed to the inventory discrepancies. Lack of adequate policies and procedures can lead to misunderstandings or inconsistencies in handling and accounting for inventory items that could allow undetected theft and potentially have a material effect on the financial statements.

Recommendation

Management should draft written inventory policies and procedures specifically for the physical inventory counts and determining and handling obsolete inventory. In addition, warehouse staff should be required to obtain the training needed to gain a mutual understanding of the current inventory system.

Management's Response

a. **Response to polices and procedures for the taking of physical inventory**: Please refer to the attachment entitled "WSG INVENTORY CYCLE COUNT PROCESS".

Response to Determining and Handling Obsolete Inventory:
Telecommunications Services will convene a Materials Review Board (MRB) that will meet quarterly to review and discuss data collected and presented by the Telephone Services Warehouse. The MRB is composed of representatives from the various Telephone Services departments having interaction with the inventory.

The MRB process will review low usage items currently active and in inventory. Some of the criteria and discussion points for the process used in making the final determination are as follows:

1. Technology trends including end of life issues that could foreshadow part obsoleteness.
2. "NEW" system installations that are replacing older systems.
3. Long term maintenance requirements for "older" installed systems.
4. Product reliability on systems where the demand for service parts is low.

Once an item/part is deemed obsolete it will be removed from the Inventory and placed in a Surplus Account in which sales tax will be added to ensure the item is surplused at the appropriate cost.

b. **Response to policies and procedures and training**:
During the Audit review process, the warehouse was in the process of transitioning to a "NEW" inventory control system. The new system is much more user friendly and comes with an extensive users help manual that is very explicit. In addition, the new system has the ability to generate comprehensive inventory control reports the lack of which in the old system created a lot of confusion and misunderstanding.

Auditor's Response

The Department's planned actions will correct the deficiencies noted in the finding. The department should also note that inventory items that are impaired or can be sold only at prices below cost should be valued at net realizable value. Net realizable value is the estimated selling price less any direct costs of disposal.

Significant Deficiency No. 2: Inventory is not being accounted for in accordance to GAAP.

a. Sales tax and shipping charges were not being included as part of the overall inventory cost for inventory items. Generally Accepted Accounting Principles (GAAP) requires all goods acquisition costs be included in the cost of inventory. Staff was not aware that acquisition costs should be included as a part of inventory. Excluding these costs causes an understatement in the overall inventory amount and an overstatement of expenses reported on the financial statements. In this case, the final 6/30/09 inventory number had to be adjusted to include sales tax.
b. New purchases are not always updated with accurate cost information. If there is not a significant change in price, the most recent purchase is sometimes left in the inventory system at the price of a previous purchase. Also, data entry errors were discovered. For accurate inventory records, all new purchases should be updated with accurate cost information; otherwise the cost of various inventory items will be misstated.

These errors occurred, in part, due to not having written procedures and formal training of staff. We do recognize that the department is in the process of implementing a new inventory system that is more user friendly.

Recommendation

Ensure staff is recording inventory costs in accordance with GAAP. Prepare written policies and procedures that adhere to GAAP requirements. Include sales tax in the fiscal year-end inventory amount submitted to General Accounting. Furthermore, employees should receive training for the inventory system.

Management's Response

a. **Response to including sales tax in the cost of inventory**:
Our current billing system pulls inventory item at cost and adds sales tax to it to bill our customers when we use inventory item in our installation or repair. That is why we enter inventory item at cost. We will add an adjusting sales tax line to our year end inventory cost.

b. **Response to new purchase item cost**:
The process for the new system requires that "All" new purchases be entered into the system with current vendor pricing. Again, this was one of the big confusion points associated with the old inventory control system.

Auditor's Response

The Department's planned actions will not entirely correct the accounting deficiencies noted in the finding. These actions will ameliorate the inventory misstatement effects reported in the Department's statement of net assets; revenues, expenses, and changes in fund net assets; and cash flows. IAS may schedule a subsequent audit of inventory to determine if the Department is accounting for its inventory in accordance with GAAP, and if necessary determine the effects on the Department's user rates.

We would like to express our appreciation for the cooperation and assistance provided to the auditor by the management and staff of the Information Services Department.

Respectfully submitted,

LARRY WALKER
Auditor-Controller/Recorder/Treasurer/Tax Collector

By: ____________________
MARK W. COUSINEAU
Chief Deputy Auditor

Quarterly copies to:

County Administrative Office
Board of Supervisors (5)
Grand Jury (2)
Audit File (3)
Date Report Distributed: 5/25/10

LDW:MWC:AKC:mah