



City of Palo Alto

City Council Staff Report

(ID # 5218)

Report Type: Consent Calendar

Meeting Date: 11/10/2014

Summary Title: Staff's Follow-up Response to Inventory Audit

Title: From Finance Committee: Staff's Second Follow-up Response to the Inventory Management Audit

From: City Manager

Lead Department: Administrative Services

Recommended Motion

The City Council approves staff's updated response to the Auditor's Inventory Management Audit.

Recommendation

Staff requests that the City Council approve this updated response to the Auditor's report on Inventory Management. The updated response addresses questions and concerns raised by the Finance Committee at its February 18, 2014 meeting. It was discussed again by the Finance Committee on October 7, 2014 and they passed a motion to refer the response to the full Council for adoption upon Consent. (See October 7 Meeting Minutes, Attachment A.)

Background and Discussion

On February 18, 2014 the City Auditor presented to the Finance Committee the results of its Inventory Management Audit. At that meeting, Council members raised several questions and concerns and asked staff to return in six months with information to speak to those concerns.

Staff (after being delayed at the Committee's request due to Members' availability) returned to the Finance Committee on October 7, 2014. Attachment B is CMR #5003 with attachments which was presented to the Committee.

The Finance Committee approved the updated response and passed the following motion:

MOTION: Council Member Berman moved, seconded by Vice Mayor Kniss, to recommend the City Council approve the City Auditor's Inventory Management Audit.

Staff appreciates the Council's consideration.

Attachments:

- Attachment A: Finance Committee Minutes from October 7, 2014 (PDF)
- Attachment B: CMR #5003 - Updated Staff Response to Inventory Audit (PDF)



FINANCE COMMITTEE MINUTES

Regular Meeting
Tuesday, October 7, 2014

Chairperson Berman called the meeting to order at 7:02 P.M. in the Council Chambers, 250 Hamilton Avenue, Palo Alto, California.

Present: Berman (Chair), Burt, Holman, Kniss

Absent:

Oral Communications

None.

Agenda Items

1. Staff's Second Follow-up Response to the Inventory Management Audit.

Chair Berman advised that the Finance Committee (Committee) directed Staff to return with the item after six months. He had continued the item so that all Committee Members could be present.

Lalo Perez, Administrative Services Director, recognized the importance of the audit and emphasized issues identified in the audit. Staff was making good progress and had addressed approximately 80 percent of recommendations. The Administrative Services Department (ASD) was working closely with Public Works, Utilities, and Information Technology (IT) Departments to address issues identified in the audit. Staff identified four key areas in the audit report. The first area was communicating policy and procedures Citywide through training and outreach to all Departments. All Departments were collaborating to implement changes which would increase accountability. A second area was tracking materials outside the system. The third area was identification of and explanation for slow moving and obsolete stock. The last area was security and turnover of inventory.

Joe Saccio, Administrative Services Assistant Director, reviewed changes provided at-places for the Detailed Revised Inventory Management Implementation Plan contained within the City Manager Report (CMR).

MINUTES

Some recommendations could not be evaluated until other recommendations had been implemented. The first task was to create Citywide policies and procedures. Policies and procedures were clear, assigned responsibilities and roles, and included steps to manage inventory. All positions responsible for managing inventory were identified. The Committee had expressed interest in tracking materials. Staff had relied on SAP and other existing systems to track stock; however, Staff would evaluate the adequacy of systems and determine whether to move more items into SAP for tracking. Transformers would not be tracked through SAP, but through an existing system. The Utilities Department would evaluate whether to track transformers through SAP in the future. Any material determined to be obsolete or unusable had been deemed surplus. Staff reviewed items more than one year old and more than three years old to ensure they were useful. Staff also assessed inventory levels. Quarterly reports would identify inventory turnover and slow-moving stock so that appropriate action could be taken. Physical security had been increased. The number of employees with access to the warehouse was greatly reduced. Cameras and card locks were instituted at the Water Quality Control Plant (WQCP). New policies and procedures would be issued on October 31, 2014 with compliance required beginning October 31, 2014. Staff considered new technologies, but determined SAP was more than adequate for the City's purposes. Once all policies and procedures were implemented, Staff would assess whether additional Staff and space were needed.

Mr. Perez advised that Staff would customize procedures for areas identified as exceptions. In areas where Staff could not implement dual controls, Staff would identify those areas and state why dual controls could not be utilized.

Mr. Saccio indicated the report was thorough and contained many details. The auditor emphasized a need for inventory policy for all Departments. Staff accomplished that through policies and procedures. Training would be instituted with Departments. Because Audit Staff was preparing an audit of meters, Staff did not include as much detail about meters in the report.

Valerie Fong, Utilities Director, committed to safeguarding and managing inventory. Staff agreed with audit recommendations and made both minor and major changes throughout the organization. Staff improved controls through forms, workflow, and authorizations; improved security of inventory through restricted access and physical locks; provided employees with more SAP training; and improved interdepartmental and intradepartmental communications.

Dave Yuan, Senior Management Analyst, reported that an audit of electric, gas, and water meters would be finalized by December 2014. The City had

MINUTES

approximately 6,000 utility poles across the City and 150 in inventory. Utility poles were ordered and tracked through SAP, stored and delivered at a substation, and counted and reconciled quarterly. The City had approximately 3,000 transformers on poles and approximately 400 in inventory. Because of the long lead time required to obtain transformers, Staff maintained a higher than normal percentage of transformers in stock. Transformers were ordered in SAP, stored in the Municipal Services Center (MSC) yard, tracked in Access, and counted and reconciled monthly. For stock used on a regular basis, Staff installed a card-access door to the area and restricted access to supervisors, leads, linemen, and warehouse personnel. Utilities Staff coordinated with other Departments to ensure adequate inventory and to be aware of changes in standards and policies and procedures.

Council Member Holman noted 600 utility poles Citywide and 150 in inventory. 25 percent in inventory seemed excessive.

Mr. Yuan clarified that there were 6,000 poles Citywide. Staff maintained 3 percent inventory for poles and 10 percent for transformers.

Council Member Holman inquired whether any contractors had access to the warehouse.

Mr. Yuan stated only City employees.

Mr. Perez advised that Public Works would provide more information on access.

Ms. Fong noted that access would be given to crews who have to respond during emergencies.

Lisa Bolger, Chief of Staff, indicated IT inventory moved quickly. IT had a storage cage at the warehouse where only warehouse Staff had card access. Only six people within IT could reserve non-valuated stock items through SAP. Staff implemented procedures for reservations and leveraged SAP for inventory management and control. Any items valued greater than \$100 were listed in SAP. Equipment and assets were properly secured and monitored. Better safeguards were instituted to ensure adequate inventory.

Vice Mayor Kniss asked if six IT Staff had access to storage.

Ms. Bolger clarified that six IT Staff could make reservations for and receive equipment.

MINUTES

Mr. Saccio remarked that access to the warehouse had two layers; the entire warehouse and restricted areas.

Vice Mayor Kniss recalled 71 access cards had been outstanding for the warehouse at the time of the Audit

Mr. Saccio reported staff members now had slightly more than 40 access cards.

James Allen, Water Quality Control Plant Manager, developed policies and procedures and supported additional security at the WQCP warehouse. For non-valuated emergency repair parts, Staff now had to check parts in and out of SAP. The WQCP warehouse was changing from an open style to a closed style. Staff would monitor for changes to work output and productivity.

Mr. Saccio advised that once all policies and procedures were implemented, Staff would assess the need for additional Staff.

Vice Mayor Kniss remarked that if Staff requested funding for additional employees, the Committee would want justification for any new positions. She assumed that greater use of SAP would reduce workload.

Mr. Perez explained that more controls resulted in more manual and system interventions. Now, Staff had more steps to follow and more steps to document. Staff would assess whether additional positions were needed to utilize all new controls.

Council Member Holman suggested an increase in efficiency would decrease the need for additional employees. If Staff requested additional positions, they should be prepared to provide details and a justification.

James Keene, City Manager, reported that Staff would consider new positions in the Fiscal Year 2016 Budget. He would request Staff research whether increased reporting, accountability, review, and transparency could be accomplished with existing staffing. New requests for information and new tasks were being placed on existing Staff daily. Staff had to work more hours or delay some tasks to complete others. He wanted to compare the benefits and costs of additional employees.

Council Member Burt commented that any increase in labor should include an analysis of savings. System efficiencies, reduced waste, and reduced cost of funds were gained from implementing procedures. He hoped Staff would consider the full picture of costs and benefits. Staff should compare costs and savings and avoid spending \$100 to save \$1.

MINUTES

Council Member Holman did not wish to overwork employees. However, more efficiency allowed more productivity and might even increase staff satisfaction. Staff should weigh all aspects.

Vice Mayor Kniss suggested Staff consider some balance between streamlining of automated systems and additional documentation.

Mr. Perez agreed that Staff would need to prove that an investment in additional Staff was worthwhile.

Chair Berman concurred with Staff waiting to assess the need for additional positions. IF Staff wished to discuss additional employees, then they would know what to expect from the Committee.

Nancy Nagel, Senior Management Analyst, recalled at the last discussion of the audit, the Committee was concerned about inventory turnover ratios. The audit indicated the inventory turnover rate (blended) was 64 percent. Separately, the MSC warehouse turnover rate was 78 percent and the WQCP warehouse rate was 25 percent. The WQCP warehouse rate was low because of the need to carry many emergency repair parts. Secondly, the auditor used numbers available as of April 19, 2013. As of June 30, 2013, that 64 percent rate increased to 78 percent, with a 91 percent rate at the MSC warehouse and 33 percent at the WQCP warehouse. The actual turnover rate for 2013 was not so bad. As for the decreasing rate from 2007 to 2013, the 2007 number was an outlier. In 2008 the inventory turnover rate decreased 10 percent, and in 2009 it decreased another 10 percent. The average inventory turnover rate over those seven years was 72 percent. The 2013 number was not below the average for those seven years. Staff conducted a two-stage clean-out of inventory and would conduct quarterly checks to identify parts not moving. The Committee should see a good turnover rate in the future.

Mr. Saccio asked Ms. Nagel to address a new base for the inventory turnover count and what the minimums represented.

Ms. Nagel explained that all Departments identified parts that were used only for emergencies. Staff coded those parts as emergency, so they could be included or segregated in calculating inventory turnover.

Council Member Holman inquired about the turnover rate for 2006. The turnover rate increased from April 2013 to June 30.

Ms. Nagel suggested that correcting and categorizing transactions at yearend could be responsible for the increase.

MINUTES

Council Member Holman stated the turnover rate still increased from 66 percent to 78 percent.

Ms. Nagel remarked that there were fluctuations.

Council Member Holman wanted to understand what caused the increase.

Ms. Nagel could analyze more issues to find an answer, but she was unsure whether Staff would continue to analyze prior years. In future reports, Staff would look more deeply into reasons for increases and decreases.

Mr. Saccio was aware of one large order at the end of the year in the gas area that may have enhanced the turnover rate.

Ms. Nagel indicated the gas order would have occurred in 2014, not in 2013

Vice Mayor Kniss inquired whether Ms. Nagel's reference to system meant SAP.

Ms. Nagel was referring to system in a broader sense.

Vice Mayor Kniss asked if she meant systemized.

Ms. Nagel replied yes. The system could be found in the policies and procedures.

Mr. Saccio advised that an order placed in the system would trigger information to purchasing to replenish stock. There was an automatic response to reorder.

Vice Mayor Kniss understood that Staff hoped to create an electronic system to know where everything was all the time.

Jon Hospitalier, Public Works Assistant Director, reported since February the Public Works Department had rekeyed the WQCP warehouse and added a security camera and card reader at the main door. IT storage at the MSC building had been caged and secured with card access. A card reader was added to the storage entrance door at City Hall. All exterior doors at City facilities with the exception of Building C and the MSC had been rekeyed with a unique configuration. Building C would be rekeyed at the end of the calendar year. Detailed records for all keys were maintained by facility Staff. Card access was installed on at least one exterior door of each facility with the exception of fire stations. More than 150 card access doors were located at City facilities. After updating and refining access records for the warehouse, only 44 Staff members possessed access cards to the MSC warehouse for 24/7 access. Public Works Staff would collaborate with the

MINUTES

Office of Emergency Services (OES) Director for guidance regarding a Citywide risk assessment. Upgrades to cameras at the MSC were underway and would be completed by the first of the year. The fleet access system was removed from all vehicles. AMAG Technology was used to track vehicle access to the entrance gate.

Mr. Saccio indicated staff would continue to input material categories into SAP when possible, to monitor and conduct blind counts, and to conduct training in SAP if requested. The key was good communication among Departments.

Mr. Perez was confident Departments would continue to work with the City Auditor and Audit Staff to complete recommendations. Internal audits made the City better.

Mr. Keene recalled Staff requested the audit. The depth and range of Staff's response had been atypical in that so many Departments were working together. These types of system changes required shared responsibility. Staff had made meaningful progress but was not finished.

Council Member Holman requested the City Auditor comment and inquired whether process guidelines in Attachment E should be process standards.

Harriet Richardson, City Auditor, appreciated Staff's approach of developing a plan. A holistic approach was best for the City. Departments worked closely with Audit Staff. Guidelines were consistent with criteria in the General Accounting Office (GAO) Executive Guide. Audit Staff could not separate moveable inventory from long-term stock for emergency purposes. Making that division clear and tracking turnover was going to be important. Transferring non-valuated stock into SAP would affect turnover rates.

Vice Mayor Kniss asked if the Inventory Management Audit would assist Audit Staff with the Meters Audit.

Ms. Richardson advised that the Meters Audit utilized the same type of criteria for management; however, it included procurement and retirement processes.

Vice Mayor Kniss felt the City was determined to have good information.

Ms. Richardson indicated risk assessment was an important concept to carry through all City processes.

MINUTES

Council Member Burt believed the Committee was looking for the type of implementation Staff utilized. It would be interesting to review costs and benefits once all controls were implemented.

Chair Berman emphasized training of Staff on new processes. He hoped the achievements in inventory management would continue.

Mr. Keene stated the City operated as a large complex organization even though it had only 1,000 employees. Sometimes force was necessary to implement change. Ultimately everyone worked together and it paid off.

MOTION: Council Member Berman moved, seconded by Vice Mayor Kniss to recommend the City Council approve the City Auditor's Inventory Management Audit.

MOTION PASSED: 4-0

Future Meetings and Agendas

Lalo Perez, Administrative Services Director, did not have any Agenda Items for the meeting of October 21, 2014. Staff recommended the meeting be canceled. The November 4, 2014 meeting was canceled as it was the date of the election. The next scheduled meeting was November 18, 2014. The Agenda included yearend financial information, Capital Improvement Program (CIP) projects, and gas cap and trade compliance revenues. The subsequent meeting was scheduled for December 2, 2014. That Agenda included first quarter financial information, and the community solar program. The December 16, 2014 meeting would include the Long Range Financial Forecast.

Vice Mayor Kniss asked if the meeting on November 21 was canceled.

Mr. Perez recommended it be canceled.

Council Member Holman indicated a League of Cities conference was scheduled around November 18, 2014.

Vice Mayor Kniss was attending the conference, but could not recall the date.

Council Member Holman noted the Animal Shelter had been outstanding for a while.

Mr. Perez reported the City Manager was working with a consultant and performing outreach with stakeholders. The item was not ready for an update.

MINUTES

Chair Berman requested Staff inquire about when an update could be provided.

Mr. Perez would talk with the City Manager. He noted two of the four Finance Committee Members could be absent from the November 18, 2014 meeting.

Vice Mayor Kniss requested Mr. Perez repeat information regarding the Animal Shelter.

Mr. Perez would request the City Manager provide a status.

Chair Berman asked Council Member Holman and Vice Mayor Kniss to notify him if they would be unavailable for the November 18 meeting.

ADJOURNMENT: Meeting adjourned at 8:25 P.M.



City of Palo Alto

Finance Committee Staff Report

(ID # 5003)

Report Type: Action Items

Meeting Date: 10/7/2014

Summary Title: Staff Response to Inventory Management Audit

Title: Staff's Second Follow-up Response to the Inventory Management Audit

From: City Manager

Lead Department: Administrative Services

Recommended Motion

The Finance Committee discussed staff's updated response to the Auditor's Inventory Management Audit and refers it to the full Council for adoption upon the Consent calendar.

Recommendation

Staff recommends that the Finance Committee review and discuss this updated response to the Auditor's report on Inventory Management. The updated response addresses questions and concerns raised by the Committee at its February 18, 2014 meeting. As discussed at the February 18 meeting, should the response adequately address Council members' concerns, staff recommends that the Committee refer the response to the full Council for adoption upon Consent.

Background

On February 18, 2014 the City Auditor presented to the Finance Committee the results of its Inventory Management Audit. Normally, the Auditor presents annual status updates to the Council. However, at the February 18 Finance Committee meeting, Council members raised several questions and concerns and asked staff to return in six months with information to speak to those concerns. This report is therefore additional to and separate from the Auditor's updates to the Council.

The text of motion, along with clarifying text, may be found below. This text is excerpted from page 18 of the full minutes of the February 18 meeting (Attachment D).

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER

1) to have this Item go to Council under the Consent Calendar; 2) to include these Minutes when the Item goes before Council; 3) to have Staff respond within six months to the Finance Committee; and 4) to have Staff account for the level of inventory, the culture of responsibility and accountability, and the tracking and disposition of the materials posted at the warehouse.

Discussion

Since February, ASD has facilitated the effort to address the Committee's concerns, by engaging through a series of meetings the Public Works, Information Technology, and Utilities departments, and methodically working through each of the Auditor's recommendations, along with the questions raised by Committee members.

Attachment A is an Implementation Plan showing tasks completed since the February 18 Finance Committee meeting as well as tasks yet to be completed. Staff estimates that the tasks it has already completed comprise about 80 percent of the total work outlined in the Implementation Plan.

Attachment B is an updated overall response to the audit from all four departments (Administrative Services, Information Technology, Public Works, and Utilities). This is the primary document for tonight's discussion. Appendix 1 of Attachment B is a report summarizing the 2014 fiscal-year-end inventory count results for both warehouses. Stores staff conducts the year-end count in addition to the cycle counts done throughout the year.

Attachment C is the staff response memorandum delivered at the February 18 Finance Committee meeting. Attachment D is the excerpted minutes from that meeting during which this agenda item was discussed. Attachment E is an Inventory Policy, Process & Procedures document which has been reviewed by all relevant departments as well as the City Auditor.

Staff looks forward to the Committee's discussion and questions.

Attachments:

- Attachment A: Inventory Management Implementation Plan (DOCX)
- Attachment B: Updated Staff Response to Inventory Audit (DOCX)
- Attachment C: Original February 2014 Response to Inventory Audit (DOCX)
- Attachment D: February 18, 2014 Finance Committee Minutes (PDF)
- Attachment E: Policy, Process & Procedures (PDF)

Attachment A

CITY OF PALO ALTO

INVENTORY MANAGEMENT

IMPLEMENTATION PLAN

PURPOSE

The purposes of this plan are:

- To provide guidance and direction to city staff regarding roles and responsibilities for achieving Inventory Management Control in keeping with Best Practices.
- To respond to the concerns raised by the Finance Committee resulting from the Inventory Management Audit, issued December 2013.
- To inform city staff about any changes in practice for addressing concerns identified in the Inventory Management Audit

IMPLEMENTATION TASKS:

NO:	TASK:	DUE DATE:	STATUS:
1.	Define "City Inventory" and create citywide policies, processes and procedures for Inventory Management.	10/31/14	Drafts have been circulated to Departments (and included in Attachment E)
2.	Ensure Best Practices inventory controls are implemented in SAP, identify reports available in SAP, and define reporting requirements including: <ul style="list-style-type: none">• System access• Segregation of duties• Minimum/Maximum• Cycle counting• Turnover• Coding emergency-only materials	DONE	Monitoring and Implementation are ONGOING
3.	Meet with departments to: <ul style="list-style-type: none">• Identify interdepartmental cross functions.• Clearly define roles and responsibilities.• Define communication needs.	DONE	

Attachment A

NO:	TASK:	DUE DATE:	STATUS:
4.	Apply the Inventory Management process procedures to all items cataloged and previously assessed to determine: <ul style="list-style-type: none"> • City inventory or not • If yes, managed in SAP or other • If other, establish criteria 	DONE	Monitoring is ONGOING
5.	For all inventory managed outside of SAP, review and approve controls established for managing that specific material.	DONE	
6.	Disseminate Final Policy, Process & Procedures and other materials Citywide	10/31/14	
7.	Complete any necessary training of City staff on PPPs	12/31/14	
8.	Evaluate whether Transformers can be brought into the main SAP inventory system	12/31/14	
9.	For all other inventory managed outside of SAP (“exceptions”), evaluate whether that type of materials can be incorporated into main SAP inventory system; re-evaluate annually; determine approximate dollar value.	DONE	IT Equipment and WQCP Emergency parts brought into SAP; Transformers, Poles left outside of SAP. Re-evaluation ONGOING
10.	Review and assess existing warehouse capacity with respect to future space needs; develop one or more options for meeting future space needs	10/31/14	
11.	Assess the appropriateness of inventory levels and establish a procedure for regular updating of material minimum and maximum inventory levels	DONE	Monitoring ONGOING
12.	Assess inventory for low turnover. Surplus or return obsolete materials. Establish procedure for regular checking of slow-moving items.	DONE For all materials in Warehouses	Monitoring ONGOING; Utilities to continue process for items they have stored outside Warehouses.

Attachment A

NO:	TASK:	DUE DATE:	STATUS:
13.	Identify and determine the treatment of other miscellaneous items such as materials and equipment: <ul style="list-style-type: none"> • Requiring short-term storage for other departments. • For recycling or disposal (DONE – see Surplus Property P&P) • Donated by contractor • Purchased with p-cards 	10/31/14	Process has been initiated
14.	Improve Physical Security of City inventory	99% Complete	MSC and WQCP security measures are completed. Fleet access control system being evaluated. Card access monitoring ONGOING.
15.	Determine steps and resources (including staff) needed to implement the updated Policies, Process and Procedures	11/30/14	
16.	Research any additional technical tools that may facilitate the practice of Inventory management Best Practices, and determine which might pass the cost-benefit test	12/31/14	Process is ongoing; December deadline for a more thorough assessment of RFID and other technologies

Attachment B

TO: City of Palo Alto Finance Committee Members
FROM: James Keene, City Manager
DATE: October 7, 2014
SUBJECT: Updated Response to Committee Members' Questions
Regarding Auditor's December 2013 Report on Inventory
Management
PREPARERS: Lalo Perez, Chief Financial Officer
Val Fong, Director of Utilities
Mike Sartor, Director of Public Works
Jonathan Reichental, Chief Information Officer

Introduction

At the Finance Committee Meeting of February 18, 2014, Committee members raised several questions and concerns and asked staff to return in August with information responsive to the issues raised.

Since February, ASD has held 20 interdepartmental meetings with Utilities, Public Works, Auditor's and Information Technology staff to address the concerns raised in the Audit. This memorandum, along with the Policy, Process & Procedures attached, documents the modifications and improvements that have resulted, as well as staff's plans for remaining action items.

The following table summarizes the issues raised by Committee members at the February 18 meeting and where in this document Council members may find staff's discussion of those concerns.

Committee Concern or Question	Status or Response
Are inventory levels appropriate?	See page 6 of this document.
Are items utilized for City projects once checked out of inventory?	Staff believes that financial system and blind counts show that what is being taken out of inventory is being put into City projects. (Counting procedures discussed on page 2.)
Concern over lack of inventory tracking and control	Counts (both cycle and year-end) indicate that inventory is well controlled. See Appendix 2.
Concern about large number of access cards at MSC	Number of persons with card access to the MSC warehouse has been reduced from 71 to 44; ongoing access card review process is now in place
Low inventory turnover ratio; unexplained decrease in inventory turnover ratio between 2007 and 2013	See pages 6 and 7 of this document.

Attachment B

The remaining document is organized into the four main issues identified in the Auditor's report, including:

1. Updating and Citywide Distribution of Inventory Policies and Procedures
2. Inventory Outside of SAP System
3. Excess of slow-moving and/or obsolete stock; low inventory turnover ratios
4. Physical security at both warehouses

Please note that the attached Policy, Process & Procedures (Attachments D, E, and F) provide important details on policy and procedural improvements that staff has developed over the last six months.

Issue 1: Update and enforce inventory transaction policies and procedures to ensure there is proper authorization and accountability for all transactions

Policy, Process, and Procedures

The Inventory Policy, Process, and Procedures (PPPs), attached to this report (Attachment E), clearly defines roles and responsibilities and the lines of interdepartmental communication necessary to manage inventory efficiently. These have been derived from continuing conversations between ASD, Utilities, Public Works, and the IT departments. Drafts of this PPP was circulated to departments, and staff incorporated their input. The PPP will then await final approval by the City Manager before being incorporated into the City's online Policies and Procedures resource and communicated to staff citywide.

Blind and Year End Physical Counts

Blind counts have been implemented and duties segregated as recommended. Cycle counts and year-end physical counts were already carried out at both locations prior to the Audit (see Appendix 1 for example) and will be continued (see Attachment E for description of cycle counting procedures).

At the WQCP, non-valuated stock in locked containers and the "towers" will be recounted annually and reconciled to SAP records. Equipment and goods stored in these areas are generally for emergency purposes only.

At the end of Fiscal Year 2014, the year-end count of valuated stock showed an accuracy rate of 98.2% at the MSC Warehouse and an accuracy rate of 97.7% at the WQCP Warehouse. The value of changes to reconcile the counts was less than 0.5% for each facility.

Accountability for Material Withdrawal: WQCP Warehouse

The WQCP has agreed to close its warehouse to the extent possible given the single FTE storekeeper. Instead of WQCP staff pulling parts off the shelves and marking on paper what they have taken so the storekeeper can enter the info into SAP (as done previously), WQCP staff will now come to the front counter, input their request into SAP, and the storekeeper will

Attachment B

obtain the parts they need. The counter has been lengthened to prevent automatic entry into the warehouse and to promote continued reliance on the storekeeper for retrieving goods.

When goods are needed after hours, authorized supervisors may access the warehouse and use an "after-hours" Pull Ticket to document what they remove from the shelves. The Storekeeper updates the system accordingly the following morning (See Attachment E).

Staff expects greater accuracy of records and enhanced protection of City assets via the more tightly controlled warehouse access.

Accountability for Material Withdrawal: MSC Warehouse

ASD eliminated the generic user account in April 2014. ASD also modified its cycle count procedures beginning December 30, 2013 to ensure that duties would be segregated according to the Auditors' recommendation. Specifically, the warehouse staff person doing the physical count and the staff person entering the count information into SAP may not be the same person.

Issue 2: Inventory Categories Ordered or Tracked Outside of SAP System: electric meters, poles, transformers, some Water Quality Control Plant equipment, IT equipment, MSC North Dock contents

As noted in the previous (February 18) response (Attachment C), there are two reasons to implement a centralized inventory management system: 1) to prevent unauthorized use, physical deterioration, or theft of property, and 2) to manage the inventory in the most cost effective manner. The majority of materials Utilities manages outside of the warehouse have an extremely low risk of theft. They are specialized goods that have no functionality or resale value outside of utility use and for the most part are heavy and bulky and cannot be transported without a flat-bed truck and crane. In addition, these materials are designed for exterior use and are not subject to deterioration from the elements or from long-term storage.

ASD met with Utilities staff overseeing transformers, poles, and meters purchasing and tracking to understand the reasons for and the mechanisms driving the alternate monitoring systems for these items. It concluded that the transformer tracking system utilized by Utilities is indeed preferable to SAP for the purposes of tracking the location of each transformer. In addition the transformers are tightly tracked by Utilities and the quantities will be reconciled with Accounting asset records twice per year. However, Utilities will take a deeper look at ways to incorporate Transformers into the regular SAP inventory system.

Poles are ordered through Stores, but due to the bulky size of the poles, are received at a separate location by Utilities staff, and distributed from that location. As a result, quarterly physical counts will be conducted to keep records reconciled.

Attachment B

As for meters, the Auditor is pursuing a more in-depth audit of the meters, so ASD and Utilities will withhold any additional recommendations or actions regarding the meters until those Audit results are presented.

In recent weeks, Utilities has identified some additional storage areas and is working to bring these items within the Policy, Process and Procedures outlined in Attachment E.

At the WQCP, an extensive amount of large equipment is located in the Towers and in outside containers. This equipment had not been counted and documented in several years. This spring, WQCP staff completed a review and organization of non-stock inventory; completed an inventory stock request form for each item; and provided the paperwork to ASD for addition to SAP as non-valuated stock. WQCP non-valuated stock is now being tracked in SAP.

For IT equipment, the following solutions were implemented:

Secured Cages: To address potential theft of desirable equipment such as computers and monitors, IT, Public Works, and MSC Warehouse Staff created an area within the warehouse to install a secured cage with a card access system. The cage extends beyond the ceiling and can only be accessed by MSC Warehouse staff. This new cage provides a secondary level of security for IT equipment at the MSC Warehouse, the first being physical access to the warehouse limited to warehouse staff only.



Items below \$100 in value (such as mice and keyboards) are considered “consumables” and are distributed to IT staff at City Hall upon receipt. IT staff then stores these items in a caged storage area in City Hall and tracks their subsequent locations.

IT Inventory Process and Procedures: IT Staff worked with the Warehouse Supervisor to establish and document IT inventory processes and procedures (See Attachment E, page 6). The document outlines what IT equipment is to be received at the warehouse, how it is to be processed, how it is to be requested, and who is permitted to request the equipment. The document also identifies that the warehouse staff will perform a blind count of IT equipment every three months to validate that inventory levels are correct.

SAP Inventory: Leveraging already in-use technology, IT Staff worked with the Warehouse Supervisor to add frequently purchased IT equipment into SAP as non-valuated inventory items. This improvement allows for an automated process of requesting goods, receiving goods, and monitoring inventory levels.

Utilities North Dock: At the MSC, Utilities maintains a storage area to facilitate crew access to low-value materials needed for jobs. Early in 2014, Utilities secured this area with a card-reader access door. In the last couple months, Utilities conducted a physical count of the items in the North Dock and evaluated whether to reduce volumes of certain items, return all the materials

Attachment B

to the MSC Warehouse, or leave as is. Utilities decided to leave the area as is, and conduct quarterly recounts of materials.

Issue 3: Slow-Moving and Obsolete Parts

Prior to the February 2014 Finance Committee meeting, Warehouse staff removed all items older than 3 years old from MSC and WQCP shelves. Since February, ASD has surveyed its customer departments regarding any parts older than 1 year, and removed the ones determined to be obsolete. In addition, ASD has requested that departments indicate which parts are for emergency repairs ONLY, since this can be coded and those parts eliminated from future “slow-moving” reports.

In the past, a key reason for slow-moving and obsolete items remaining on the MSC Warehouse shelves was a communication gap between Utilities and MSC Warehouse and purchasing staff, as well as an information lag between Utilities Engineering and Utilities Operations staff – for example, regarding changed specifications on parts. One outcome of the discussions between ASD and Utilities has been that Utilities has started inviting Purchasing and Stores to monthly Engineering and Operations meetings to address any material issues or specification changes. Utilities will also review the quarterly slow moving material report from Stores to address aging or obsolete inventory.

Another concern of the Committee upon reviewing the Auditor’s report in February was the overall 64% inventory turnover ratio for City warehouses in 2013. Staff investigated and found that the 64% turnover was for the period from July 1 2012 to April 29, 2013, and was a blended rate for the two warehouses. The MSC warehouse turnover rate was 78.0%, and the WQCP warehouse turnover rate was 24.6% for the same period. (See table excerpted from Auditor’s calculations below.)

Calculated - Based on MB51 and ZMMR05	
MSC Inventory Turnover as a % of MSC Total Inventory on 4/19/13	WQCP Inventory Turnover as a % of WQCP Total Inventory on 4/19/13
78.0%	24.6%

The reason for the low turnover rate at the WQCP is that they keep a large number of materials on hand in case of emergency. The cost of delaying a needed repair to the system, including environmental impacts of spilling waste into the Bay and penalties for the plant’s inability to process the waste from partner agencies’ systems, would be much higher than the carrying costs for these replacement parts.

Attachment B

Questions were also raised regarding the reported decline in overall turnover ratio from 88% at Fiscal-year-end 2007 to 64% as of April 2013.

A look at the details of the Auditor's analysis might help clarify the trend. The year-end (6-30-13) calculation is added in bold in the table below:

Date (Fiscal Year as of)	Inventory Turnover (Calculated)
6/30/2013	77.5%
4/19/2013	64.2%
6/30/2012	65.8%
6/30/2011	63.4%
6/30/2010	64.5%
6/30/2009	66.1%
6/30/2008	76.4%
6/30/2007	88.0%

First, the 88% turnover ratio in FY 2007 was relatively high compared to the succeeding six years. The inventory turn ratio change between 2008 and April 19, 2013 was far less dramatic than that from 2007 to 2013.

Second, 2013's year-end turnover ratio was 78% - rather than the 64% figure-based on April 2013 numbers shown in the Auditor's report. Broken out by location, the MSC turnover rate was 91.3%; the WQCP's was 33.0% for FY 2013.

Going forward, staff has already cleaned out obsolete materials from both warehouses and coded emergency-only supplies so that inventory turns can be calculated with and without them. Finally, as the PPP demonstrates, there is now a system in place to routinely synchronize information regarding slow-moving, obsolete, and newly specified parts and materials. Inventory turn levels will be more closely monitored, and likely much higher, than in recent years, when a high volume of emergency-only stock was included in the calculations.

Issue 4: Physical Security at Both Warehouses

Since February, Public Works has re-keyed the WQCP warehouse, and added a security camera and a card reader to the main door. The IT storage area at MSC-A has now been caged, with the cage fencing extended, and is secured with a padlock. Card access was added to this cage in August. Card access was also added to the storage entrance door at City Hall Level A.

All of the exterior doors of City facilities with the exception MSC-C have been rekeyed with the new Schlage Primus key system. MSC-C will be complete by the end of the calendar year.

Card access has been installed on at least one exterior door on each of the facilities with the

Attachment B

exception of fire stations. There are now over 135 card access doors installed in City facilities, which greatly reduces the need to issue hard keys. Detailed records are kept for all keys issued for this new Schlage Primus system.

44 staff members currently possess access cards to the MSC warehouse.

Public Works staff will collaborate with the City's OES Director for recommendations and guidance working toward a citywide risk assessment.

At the MSC, the Fleet access system has now been removed and all vehicle access cards are now using the AMAG Technology system, which has the ability to track when vehicles gain access to the entrance gate.

Conclusions and Next Steps

Staff's takeaways from the February 18 Finance Committee meeting were concerns about:

- The safety and protection of all goods purchased and stored by the City
- The ability to track all goods
- The efficient use and turnover of inventory

Since that meeting, staff has taken numerous actions to address the Finance Committee's issues as well as the Auditor's findings.

Security for City goods has been enhanced by more strictly limiting access cards to the MSC warehouse, installing a cage to protect computer equipment, and installing a new card access system and camera coverage at the WQCP. The WQCP Warehouse has been made additionally secure by changing the practice of having crews fill out paperwork and then pick up parts off the warehouse shelves directly and instead have the storekeeper bring out the parts after paperwork has been completed. The effort to further secure the entire MSC complex is still a work in progress with Public Works and the Office of Emergency Services taking the lead.

With some closely monitored exceptions, all goods discussed in the Auditors Report are now tracked in SAP, either as "stock inventory" – parts that are used repeatedly – or "non-valuated inventory" – parts that are for emergencies only or for other reasons do not qualify as stock items. The latter's quantities, but not values, are tracked in SAP's inventory system.

Staff in both Public Works and Utilities (along with Purchasing and Stores staff) has made significant strides to count and track goods managed outside the SAP inventory system. Counts will be performed on a periodic basis to balance the number of goods in storage and those listed in SAP. Utilities will continue to track transformers in its Access system and will log and account for all goods located in sheds, containers, and a caged area at the MSC dock. ASD will continue to evaluate whether goods outside the standard SAP system can be brought into the main inventory system.

Attachment B

All goods in both warehouses have been analyzed for obsolescence and low turnover. Obsolete items have been either returned to vendors or surplused according to City policy. Goods that have been identified as emergency items have been specially coded so Inventory Turn ratios may be calculated excluding these items. Warehouse staff will now send quarterly turnover and aging reports to departments for the potential culling of unused items.

In staff's view, expensive solutions to audit issues are not required and most can be solved with existing personnel levels and systems. For example, the benefits of adding a more robust inventory module in SAP for approximately \$500,000 do not outweigh the costs. This is especially true given Information Technology's efforts in progress to evaluate SAP versus other ERP systems. However, to manage the increased back-and-forth reporting and accountability between Stores and departments on changing material needs, it might be necessary to restore the 1 FTE that was cut from Stores.

There remain, however, a number of additional tasks to see the process through. Attachment A, the Implementation Plan, includes the tasks staff has planned going forward. For example, Utilities will re-evaluate whether Transformers can be brought into the main SAP inventory system; Utilities staff is beginning to process some additional materials identified in recent weeks as falling under the purview of the newly outlined Policy, Process & Procedures; staff will assess current and future warehouse space needs and make recommendations; additional technical solutions and possible additional staffing needs will be evaluated.

In summary, a significant effort in tightening inventory management and controls has been made. A Policy, Process, and Procedures (PPPs) document has been drafted and shared with departments so that responsibilities and lines of communication are clear. As long as departments consistently adhere to the PPPs, the City's assets will be efficiently and effectively used.

Attachment B
Appendix 1: Year-End Physical Count Results

Final FYE 2014 Inventory facts & figures for MSC & WQCP

General Information

- MSC Warehouse houses 1865 active material stock items
- WQCP Warehouse houses 2354 active material stock items
- The net worth of MSC stock is \$3,089,312. WQCP is \$837,824.

MSC Warehouse

Material Document 4800060358 shows 20 physical inventory (**negatives**) errors entered into SAP on 6/23.

Document was generated using MB51 (*Parameters - CPA, MSC, Movement Code 702, posting Date*)

Report shows a total lost in dollars of \$24,501. Of that total, \$24,259 is related to the pole counts given by Utilities.

The true dollar loss of stock tracked & controlled by ASD/Stores was **(-\$242)**

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn Σ	Amount in LC	Order	Cost Center
004...	Sign No Parking PWOPS, Storms,SW 50/pk	4800060358	06/23/2014	1-	PK	5.89-		10900000
0301...	Coupling, Slip 5" P&C	4800060358	06/23/2014	1-	EA	5.28-		10900000
0301...	Coupling, PVC 2" Conduit	4800060358	06/23/2014	2-	EA	2.55-		10900000
0342...	Pole, Wood 35 ft Class 3	4800060358	06/23/2014	4-	EA	1,780.79-		10900000
0342...	Pole, Wood 40 ft Class 5	4800060358	06/23/2014	4-	EA	1,162.16-		10900000
0342...	Pole, Wood 45 Ft Class 5	4800060358	06/23/2014	8-	EA	2,871.95-		10900000
0342...	Pole, Wood 50 Ft Class 3	4800060358	06/23/2014	7-	EA	4,768.80-		10900000
0342...	Pole, Wood 55 Ft Class 3	4800060358	06/23/2014	9-	EA	6,239.17-		10900000
0342...	Pole, Wood 65 Ft Class 2	4800060358	06/23/2014	3-	EA	2,653.00-		10900000
0342...	Pole, wood 70 Ft Class 2	4800060358	06/23/2014	2-	EA	2,865.59-		10900000
0342...	Pole, Wood 75 Ft Class 2	4800060358	06/23/2014	2-	EA	1,933.84-		10900000
0365...	Connector, Service Sleeve Red/Red	4800060358	06/23/2014	50-	EA	18.46-		10900000
0900...	Gloves, Neox Coated Size 10	4800060358	06/23/2014	10-	P...	107.13-		10900000
0900...	Gloves, Drivers 2X-Large	4800060358	06/23/2014	7-	P...	35.63-		10900000
0900...	Gloves, Nitrile, Size 9 (Med)	4800060358	06/23/2014	3-	P...	5.53-		10900000
0900...	Gloves, Leather Utility Medium	4800060358	06/23/2014	1-	P...	5.98-		10900000
0913...	Screw, Hex Cap PTD 1/2-13x2-1/2	4800060358	06/23/2014	1-	EA	0.32-		10900000
0931...	Hammer Claw 22 Oz Fiberglass Handle	4800060358	06/23/2014	1-	EA	34.17-		10900000
0940...	Lamp Flashlight, PR-3(3-Cell)	4800060358	06/23/2014	1-	EA	0.91-		10900000
0950...	Glasses, Safety "Bandit" Clear	4800060358	06/23/2014	1-	EA	4.72-		10900000
						24,501.87-		

Material Document 4800060358 shows 12 physical inventory (**positives**) errors entered in SAP on 6/23
Document was generated using MB51 (*Parameters - CPA, MSC, Movement Code 701, posting Date*)

Report shows a total gain in dollars of \$12,659. Of that total, \$12,522 is related to the pole counts given by Utilities.

The true dollar gain of stock tracked & controlled by ASD/Stores was **\$136**

Attachment B

Appendix 1

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn Σ	Amount in LC	Order	Cost Center
034...	Pole, Wood 40 Ft Class 3	4800060358	06/23/2014	2	EA	978.86		10900000
0342...	Pole, Wood 45 Ft Class 3	4800060358	06/23/2014	16	EA	8,848.87		10900000
0342...	Pole, Wood 60 Ft Class 3	4800060358	06/23/2014	3	EA	2,694.55		10900000
0360...	Connector, Sleeve IKL45 2/0-#2 RED	4800060358	06/23/2014	2	EA	6.15		10900000
0362...	Connector, AMP 1/0 ACSR/AL - 1/0-4 CU/AL	4800060358	06/23/2014	2	EA	5.63		10900000
0388...	End Cap, Cold Shrink EC-3 (500-1000)	4800060358	06/23/2014	1	EA	5.90		10900000
0428...	Plug, Expander 3/4"	4800060358	06/23/2014	2	EA	8.21		10900000
0430...	Riser, Meter Straight 1"CTS x 3/4" MPT	4800060358	06/23/2014	1	EA	26.86		10900000
0900...	Gloves, Drivers X-Large	4800060358	06/23/2014	7	P...	36.07		10900000
0900...	Gloves, Nitrile Insul LG 24" SZ 10 (WGW)	4800060358	06/23/2014	1	P...	18.89		10900000
0931...	Hammer Claw 16 Oz	4800060358	06/23/2014	1	EA	22.26		10900000
0951...	Sqwincher Fruit Punch 2.5gl	4800060358	06/23/2014	2	PK	6.86		10900000
						12,659.11		

Material Document 4800060358 32 physical inventory errors entered into SAP on 6/23
Document was generated using MB51 (Parameters - CPA, MSC, Movement Code 701/702, posting Date)

Report shows a total loss in dollars of **(-\$11,842)**

The true dollar gain/loss of stock tracked & controlled by ASD/Stores was **(-\$105)**

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn Σ	Amount in LC	Order	Cost Center
004...	Sign No Parking PWOPS, Storms,SW 50/pk	4800060358	06/23/2014	1-	PK	5.89-		10900000
0301...	Coupling, Slip 5" P&C	4800060358	06/23/2014	1-	EA	5.28-		10900000
0301...	Coupling, PVC 2" Conduit	4800060358	06/23/2014	2-	EA	2.55-		10900000
0342...	Pole, Wood 35 Ft Class 3	4800060358	06/23/2014	4-	EA	1,780.79-		10900000
0342...	Pole, Wood 40 Ft Class 3	4800060358	06/23/2014	2	EA	978.86		10900000
0342...	Pole, Wood 40 Ft Class 5	4800060358	06/23/2014	4-	EA	1,162.16-		10900000
0342...	Pole, Wood 45 Ft Class 3	4800060358	06/23/2014	16	EA	8,848.87		10900000
0342...	Pole, Wood 45 Ft Class 5	4800060358	06/23/2014	8-	EA	2,871.95-		10900000
0342...	Pole, Wood 50 Ft Class 3	4800060358	06/23/2014	7-	EA	4,768.80-		10900000
0342...	Pole, Wood 55 Ft Class 3	4800060358	06/23/2014	9-	EA	6,239.17-		10900000
0342...	Pole, Wood 60 Ft Class 3	4800060358	06/23/2014	3	EA	2,694.55		10900000
0342...	Pole, Wood 65 Ft Class 2	4800060358	06/23/2014	3-	EA	2,653.00-		10900000
0342...	Pole, wood 70 Ft Class 2	4800060358	06/23/2014	2-	EA	2,865.59-		10900000
0342...	Pole, Wood 75 Ft Class 2	4800060358	06/23/2014	2-	EA	1,933.84-		10900000
0360...	Connector, Sleeve IKL45 2/0-#2 RED	4800060358	06/23/2014	2	EA	6.15		10900000
0362...	Connector, AMP 1/0 ACSR/AL - 1/0-4 CU/AL	4800060358	06/23/2014	2	EA	5.63		10900000
0365...	Connector, Service Sleeve Red/Red	4800060358	06/23/2014	50-	EA	18.46-		10900000
0388...	End Cap, Cold Shrink EC-3 (500-1000)	4800060358	06/23/2014	1	EA	5.90		10900000
0428...	Plug, Expander 3/4"	4800060358	06/23/2014	2	EA	8.21		10900000
0430...	Riser, Meter Straight 1"CTS x 3/4" MPT	4800060358	06/23/2014	1	EA	26.86		10900000
0900...	Gloves, Neox Coated Size 10	4800060358	06/23/2014	10-	P...	107.13-		10900000
0900...	Gloves, Drivers X-Large	4800060358	06/23/2014	7	P...	36.07		10900000
0900...	Gloves, Nitrile Insul LG 24" SZ 10 (WGW)	4800060358	06/23/2014	1	P...	18.89		10900000
0900...	Gloves, Drivers 2X-Large	4800060358	06/23/2014	7-	P...	35.63-		10900000
0900...	Gloves, Nitrile, Size 9 (Med)	4800060358	06/23/2014	3-	P...	5.53-		10900000
0900...	Gloves, Leather Utility Medium	4800060358	06/23/2014	1-	P...	5.98-		10900000
0913...	Screw, Hex Cap PTD 1/2-13x2-1/2	4800060358	06/23/2014	1-	EA	0.32-		10900000
0931...	Hammer Claw 16 Oz	4800060358	06/23/2014	1	EA	22.26		10900000
0931...	Hammer Claw 22 Oz Fiberglass Handle	4800060358	06/23/2014	1-	EA	34.17-		10900000
0940...	Lamp Flashlight, PR-3(3-Cell)	4800060358	06/23/2014	1-	EA	0.91-		10900000
0950...	Glasses, Safety "Bandit" Clear	4800060358	06/23/2014	1-	EA	4.72-		10900000
0951...	Sqwincher Fruit Punch 2.5gl	4800060358	06/23/2014	2	PK	6.86		10900000
						11,842.76-		

MSC Final Inventory numbers

Items counted **1865** Errors **32** Inventory Accuracy Rate **98.2%** Value change Less than **.5%**

Attachment B
Appendix 1

WQCP Warehouse

Material Document 4800060359 shows 39 physical inventory (negatives) errors entered into SAP on 6/23.

Document was generated using MB51 (Parameters - CPA, WQCP, Movement Code 702, posting Date)

Report shows a total lost in dollars of \$296.

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn ²	Amount in LC	Order	Cost Center
018...	Connector, 1/4 Poly-1/8 M-NPT	4800060359	06/23/2014	1-	EA	1.23-		10900000
0195...	Tee, Brass, 1/8"	4800060359	06/23/2014	4-	EA	12.80-		10900000
0195...	Tee, Brass, 1/4"	4800060359	06/23/2014	1-	EA	3.30-		10900000
0195...	Tee, Brass, 1/2"	4800060359	06/23/2014	2-	EA	7.95-		10900000
0197...	Union, Brass, 1/2"	4800060359	06/23/2014	2-	EA	12.43-		10900000
0220...	Bushing, Brass, 1" x 3/4	4800060359	06/23/2014	3-	EA	22.48-		10900000
0293...	Nipple Galv., 1-1/2xcl	4800060359	06/23/2014	2-	EA	2.65-		10900000
0370...	Clamp, Hose, S/S, 1/2"-1-1/4"	4800060359	06/23/2014	8-	EA	8.26-		10900000
0370...	Clamp, Hose, S/S 9/16 - 1 1/16	4800060359	06/23/2014	3-	EA	3.14-		10900000
0370...	Clamp, Hose, S/S 1 1/16 - 2"	4800060359	06/23/2014	11-	EA	11.82-		10900000
0390...	Connector, Sheath Cable 1/2"	4800060359	06/23/2014	1-	EA	1.48-		10900000
0391...	Strap, EMT Steel Snap-On 1/2"	4800060359	06/23/2014	6-	EA	1.93-		10900000
0394...	Connector, Thdless Rigid 1/2"	4800060359	06/23/2014	1-	EA	2.89-		10900000
0396...	Reducer, Threaded, 3/4 x 1/2	4800060359	06/23/2014	4-	EA	2.96-		10900000
0399...	Gasket, Conduit Body, 1/2"	4800060359	06/23/2014	1-	EA	0.63-		10900000
0399...	Gasket, Conduit Body, 3/4"	4800060359	06/23/2014	1-	EA	0.61-		10900000
0480...	Adapter-Female, PVC-SCH80, 3/8"	4800060359	06/23/2014	1-	EA	1.64-		10900000
0480...	Adapter-Male, PVC-SCH80, 1/2"	4800060359	06/23/2014	1-	EA	1.11-		10900000
0480...	Bushing, PVC80, 1-1/2x1-1/4TxT	4800060359	06/23/2014	2-	EA	6.60-		10900000
0481...	Coupling, PVC-SCH80, 3/4" TxT	4800060359	06/23/2014	3-	EA	4.99-		10900000
0482...	Coupling, PVC80, 1/2" Soc	4800060359	06/23/2014	1-	EA	1.20-		10900000
0483...	Nipple, PVC80, 1/2 x 6"	4800060359	06/23/2014	1-	EA	1.17-		10900000
0484...	Nipple, PVC80, 1-1/2 x 2"	4800060359	06/23/2014	1-	EA	0.65-		10900000
0484...	Nipple, PVC80, 1-1/2 x 2-1/2	4800060359	06/23/2014	2-	EA	2.39-		10900000
0486...	Union, PVC-SCH80, 1" S	4800060359	06/23/2014	1-	EA	3.45-		10900000
0501...	Bottle, for Trigger Sprayer (Empty)	4800060359	06/23/2014	1-	EA	0.67-		10900000
0511...	Mosquito Repellent, Spray 4 oz.	4800060359	06/23/2014	3-	EA	22.69-		10900000
0640...	Drain King, Unclogg 1"-2"	4800060359	06/23/2014	1-	EA	8.46-		10900000
0705...	Plug, Brg. Lock Moyno 1F036G1	4800060359	06/23/2014	9-	EA	3.23-		10900000
0820...	Respirator, Face Piece Only Sm	4800060359	06/23/2014	1-	EA	22.92-		10900000
0820...	Envelope, Plastic 3-1/2x6-1/4	4800060359	06/23/2014	8-	EA	24.70-		10900000
0820...	Filter, Respirator Canister	4800060359	06/23/2014	1-	EA	8.20-		10900000
0820...	Cooling Hard Hat Pad w/neck Shade	4800060359	06/23/2014	5-	EA	18.24-		10900000
0835...	Coupling, Air, 1/4" M-Insert	4800060359	06/23/2014	5-	EA	4.05-		10900000
0835...	Gun, Air Blow, 1/4" F-NPT Inle	4800060359	06/23/2014	1-	EA	10.49-		10900000
0933...	Screwdriver 4"	4800060359	06/23/2014	3-	EA	11.37-		10900000
0933...	Screwdriver Phillips #1, 3"	4800060359	06/23/2014	2-	EA	9.23-		10900000
0939...	Lubricant, LPS, Spray, 12 oz.	4800060359	06/23/2014	1-	EA	7.19-		10900000
0941...	Lamp Mini, Mini Bayonet Base	4800060359	06/23/2014	10-	EA	24.90-		10900000
						296.10-		

Material Document 4800060359 shows 13 physical inventory (Positives) errors entered into SAP on 6/23.

Document was generated using MB51 (Parameters - CPA, WQCP, Movement Code 701, posting Date)

Report shows a total gain in dollars of \$405.

Attachment B
Appendix 1

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn	Σ	Amount in LC	Order	Cost Center
019...	Nipple, Brass, 1/2" x 2"	4800060359	06/23/2014	1	EA		1.94		10900000
0195...	Plug Brass, 1/8"	4800060359	06/23/2014	1	EA		0.98		10900000
0195...	Tee, Brass, 3/4"	4800060359	06/23/2014	1	EA		4.53		10900000
0195...	Tee, Brass, 1"	4800060359	06/23/2014	1	EA		17.47		10900000
0255...	Valve-Check, Brass, 3/4-NPT	4800060359	06/23/2014	1	EA		6.00		10900000
0290...	Coupling, Galv., 1-1/4	4800060359	06/23/2014	1	EA		1.69		10900000
0395...	Elbow, Rigid Conduit, 45-1"	4800060359	06/23/2014	1	EA		5.50		10900000
0396...	Knockout Seal, Wing-nut 3/4"	4800060359	06/23/2014	2	EA		1.14		10900000
0483...	Nipple, PVC80, 3/8 x 6"	4800060359	06/23/2014	1	EA		0.65		10900000
0501...	Soap, Bar Lava	4800060359	06/23/2014	3	EA		4.24		10900000

Continued on next page

0839...	Marpene Tubing, Loadsure 17mm	4800060359	06/23/2014	2	EA		214.97		10900000
0839...	Marpene Tubing, Loadsure 17mm, TM	4800060359	06/23/2014	1	EA		107.24		10900000
0960...	Tape, Barrier "Caution	4800060359	06/23/2014	8	R..		39.00		10900000
							405.35		

Material Document 4800060359 shows 52 physical inventory errors entered into SAP on 6/23. Document was generated using MB51 (Parameters - CPA, WQCP, Movement Code 701/702, posting Date)

Report shows an overall gain in dollars of **\$109.**

Attachment B
Appendix 1

Material	Material Description	Material Doc.	Posting Date	Quantity	EUn	Σ	Amount in LC	Order	Cost Center
018...	Connector, 1/4 Poly-1/8 M-NPT	4800060359	06/23/2014	1-	EA		1.23-		10900000
0192...	Nipple, Brass, 1/2" x 2"	4800060359	06/23/2014	1	EA		1.94		10900000
0195...	Plug Brass, 1/8"	4800060359	06/23/2014	1	EA		0.98		10900000
0195...	Tee, Brass, 1/8"	4800060359	06/23/2014	4-	EA		12.80-		10900000
0195...	Tee, Brass, 1/4"	4800060359	06/23/2014	1-	EA		3.30-		10900000
0195...	Tee, Brass, 1/2"	4800060359	06/23/2014	2-	EA		7.95-		10900000
0195...	Tee, Brass, 3/4"	4800060359	06/23/2014	1	EA		4.53		10900000
0195...	Tee, Brass, 1"	4800060359	06/23/2014	1	EA		17.47		10900000
0197...	Union, Brass, 1/2"	4800060359	06/23/2014	2-	EA		12.43-		10900000
0220...	Bushing, Brass, 1" x 3/4	4800060359	06/23/2014	3-	EA		22.48-		10900000
0255...	Valve-Check, Brass, 3/4-NPT	4800060359	06/23/2014	1	EA		6.00		10900000
0290...	Coupling, Galv., 1-1/4	4800060359	06/23/2014	1	EA		1.69		10900000
0293...	Nipple Galv., 1-1/2xcl	4800060359	06/23/2014	2-	EA		2.65-		10900000
0370...	Clamp, Hose, S/S, 1/2"-1-1/4"	4800060359	06/23/2014	8-	EA		8.26-		10900000
0370...	Clamp, Hose, S/S 9/16 - 1 1/16	4800060359	06/23/2014	3-	EA		3.14-		10900000
0370...	Clamp, Hose, S/S 1 1/16 - 2"	4800060359	06/23/2014	11-	EA		11.82-		10900000
0390...	Connector, Sheath Cable 1/2"	4800060359	06/23/2014	1-	EA		1.48-		10900000
0391...	Strap, EMT Steel Snap-On 1/2"	4800060359	06/23/2014	6-	EA		1.93-		10900000
0394...	Connector, Thdless Rigid 1/2"	4800060359	06/23/2014	1-	EA		2.89-		10900000
0395...	Elbow, Rigid Conduit, 45-1"	4800060359	06/23/2014	1	EA		5.50		10900000
0396...	Knockout Seal, Wing-nut 3/4"	4800060359	06/23/2014	2	EA		1.14		10900000
0396...	Reducer, Threaded, 3/4 x 1/2	4800060359	06/23/2014	4-	EA		2.96-		10900000
0399...	Gasket, Conduit Body, 1/2"	4800060359	06/23/2014	1-	EA		0.63-		10900000
0399...	Gasket, Conduit Body, 3/4"	4800060359	06/23/2014	1-	EA		0.61-		10900000
0480...	Adapter-Fmale, PVC-SCH80, 3/8"	4800060359	06/23/2014	1-	EA		1.64-		10900000
0480...	Adapter-Male, PVC-SCH80, 1/2"	4800060359	06/23/2014	1-	EA		1.11-		10900000
0480...	Bushing, PVC80, 1-1/2x1-1/4TxT	4800060359	06/23/2014	2-	EA		6.60-		10900000
0481...	Coupling, PVC-SCH80, 3/4" TxT	4800060359	06/23/2014	3-	EA		4.99-		10900000
0482...	Coupling, PVC80, 1/2" Soc	4800060359	06/23/2014	1-	EA		1.20-		10900000
0483...	Nipple, PVC80, 3/8 x 6"	4800060359	06/23/2014	1	EA		0.65		10900000
0483...	Nipple, PVC80, 1/2 x 6"	4800060359	06/23/2014	1-	EA		1.17-		10900000
0484...	Nipple, PVC80, 1-1/2 x 2"	4800060359	06/23/2014	1-	EA		0.65-		10900000
0484...	Nipple, PVC80, 1-1/2 x 2-1/2	4800060359	06/23/2014	2-	EA		2.39-		10900000
0486...	Union, PVC-SCH80, 1" S	4800060359	06/23/2014	1-	EA		3.45-		10900000
0501...	Bottle, for Trigger Sprayer (Empty)	4800060359	06/23/2014	1-	EA		0.67-		10900000
0501...	Soap, Bar Lava	4800060359	06/23/2014	3	EA		4.24		10900000
0511...	Mosquito Repellent, Spray 4 oz.	4800060359	06/23/2014	3-	EA		22.69-		10900000
0640...	Drain King, Unclogg 1"-2"	4800060359	06/23/2014	1-	EA		8.46-		10900000
0705...	Plug, Brg. Lock Moyno 1F036G1	4800060359	06/23/2014	9-	EA		3.23-		10900000
0820...	Respirator, Face Piece Only Sm	4800060359	06/23/2014	1-	EA		22.92-		10900000
0820...	Envelope, Plastic 3-1/2x6-1/4	4800060359	06/23/2014	8-	EA		24.70-		10900000
0820...	Filter, Respirator Canister	4800060359	06/23/2014	1-	EA		8.20-		10900000
0820...	Cooling Hard Hat Pad w/neck Shade	4800060359	06/23/2014	5-	EA		18.24-		10900000
0835...	Coupling, Air, 1/4" M-Insert	4800060359	06/23/2014	5-	EA		4.05-		10900000
0835...	Gun, Air Blow, 1/4" F-NPT Inle	4800060359	06/23/2014	1-	EA		10.49-		10900000
0839...	Marprene Tubing, Loadsure 17mm	4800060359	06/23/2014	2	EA		214.97		10900000
0839...	Marprene Tubing, Loadsure 17mm, TM	4800060359	06/23/2014	1	EA		107.24		10900000
0933...	Screwdriver 4"	4800060359	06/23/2014	3-	EA		11.37-		10900000
0933...	Screwdriver Phillips #1, 3"	4800060359	06/23/2014	2-	EA		9.23-		10900000
0939...	Lubricant, LPS, Spray, 12 oz.	4800060359	06/23/2014	1-	EA		7.19-		10900000
0941...	Lamp Mini, Mini Bayonet Base	4800060359	06/23/2014	10-	EA		24.90-		10900000
0960...	Tape, Barrier "Caution	4800060359	06/23/2014	8	R..		39.00		10900000
							109.25		

WQCP Final Inventory numbers

Items counted **2354** Errors **52** Inventory Accuracy Rate **97.7%** Value change Less than **.5%**

Attachment C

TO: Houman Boussina, Acting City Auditor

FROM: James Keene, City Manager

DATE: February 18, 2014

SUBJECT: City Manager's Preliminary Response to the "Inventory Management Audit"

PREPARERS: Lalo Perez, Chief Financial Officer
Val Fong, Director of Utilities
Mike Sartor, Director of Public Works
Jonathan Reichental, Chief Information Officer

Response

City staff would like to thank the Auditor's Office for a detailed Inventory Audit with worthwhile recommendations to investigate and act upon. It is important to note that this audit was conducted at management's recommendation. Fundamentally, staff believes there is room for improvement in areas cited in the Auditor's conclusion including:

- Controls to ensure accuracy and completeness of inventory records
- Accountability for inventory movements
- Enforcing citywide inventory management standards and continuous improvements

What is being accomplished and what requires attention is discussed in department responses below. For example, where the Auditor recommends using the City's SAP inventory system, which staff will seek to maximize, there are current and new systems that could be used more cost effectively to achieve cited goals. These systems will be examined.

Because the City's inventory is geographically dispersed; controlled by different departments; and covered by older policies and procedures, staff requested the Auditor conduct an analysis of our goods management and compare it to best practices. Although management's perspective and emphasis may be slightly different from that of the Auditor, it has developed an action plan to improve current practices and address the Auditor's recommendations.

There are always a number of themes and natural tensions at play between best practices and operational needs in appropriately managing inventory. These include:

- A conflict between operational needs and efficiencies, particularly in regards to emergencies, time sensitive projects, or running a 24/7 operation versus tight and accurate inventory control

Attachment C

- A tradeoff between precise inventory control and accuracy and the costs necessary to achieve such goals. Over the past decade, 2 positions have been eliminated at the warehouses as a consequence of balancing budgets
- Limited physical space at the Regional Water Quality Control Plant and MSC warehouses as well as at the MSC yard. Goods will occasionally be stored in available spaces making centralized versus decentralized storage of goods problematical
- The City of Palo Alto is unique as a municipality given ownership of all utilities. This adds complexity to the receipt, evaluation, storage, and management of goods

The Auditor cites the Municipal Code as assigning to the Administrative Services Department (ASD) the principal responsibility for inventory management. As a full service City providing general and utility services, this responsibility is more complicated and diffused than in other jurisdictions. In addition, to updating policies and procedures to reflect best practices, ASD will include language that makes responsibility for the transitioning and safeguarding of goods clear. This may include recommended modifications to the Municipal Code. Once an item is removed or issued from City warehouses, it becomes the user department's responsibility to safeguard that item. ASD staff will work closely with departments to educate and ensure that achievable best practices are followed.

Finding 1 – ASD and City departments should implement the City's inventory management policies and procedures citywide to achieve inventory goals and objectives

Recommendations:

- 1. ASD and City departments should implement the City's inventory management policies and procedures citywide to achieve inventory goals and objectives**
- 2. ASD should review its inventory accounting policies and correct any misstatements in the City's accounting records**

ASD

An updating of citywide inventory policies and procedures is necessary. ASD is committed to revising them and to working with departments to implement. Our goals and objectives are and will continue to be aligned with those of the Government Accountability Office (GAO) guidelines cited in the Auditor's Report. In addition, ASD will propose changes to code, policies and procedures that define department responsibilities for tracking and safeguarding goods that leave the warehouses. Ongoing meetings among departments involved in inventory management will be scheduled.

ASD has reviewed the Auditors pre and final findings concerning its accounting policies with the City's outside financial auditor firm Macias, Gini and O'Connell (MGO), and concluded that there were no material misstatements in the City's FY 2013 accounting records pertaining to inventory.

Attachment C

Utilities

To implement policies and procedures, staff will evaluate existing (e.g., SAP) and potential new systems to enhance the monitoring and controlling of inventory. City staff agrees that it would be advantageous to have a single inventory management system for all the materials used by the City. It is important, however, to evaluate whether there are cost effective solutions providing sufficient benefit to justify the expense of implementing and operating the systems. From a business process and/or cost perspective, SAP may not be the optimal system for inventory management. In addition, the IT department is leading the review and assessment of the SAP system for ongoing use. For example, detailed tracking of low price items such as bolts and nuts once they leave the warehouse would require more labor and increase costs. It is likely that these increased costs would exceed the value of the materials.

The Utilities Department stores over \$82,000 in inventory at an unsecured location without oversight

Utilities

It is not uncommon for Utilities to have a store of low priced and revolving stock items (average cost of less than \$5 each for items such as nuts, bolts, washers, etc. amounting to 17,500 such items) for general use outside of the materials management system. For operational and cost reasons, it is impractical to keep an up-to-date manual inventory system.

If it is deemed necessary to inventory these parts, an automated system is required to streamline the inventory management. The costs and benefits of such a system would be compared to determine the cost effectiveness of such a system. In the short-term, a locked door at the “unsecured location” to restrict access to the storage area will be added.

The Utilities Department disposed of at least \$31,000 in unused materials that had expired

Utilities

The Utilities use a variety of materials that do have defined shelf lives. There are instances in which older, unique goods may be kept for repairs. Utilities does acknowledge the disposal of items that were no longer useful. In the future, Utilities will be sure to observe City procedures for surplus or obsolete inventory.

The current inventory management system does not track individual items so identifying materials nearing expiration dates is difficult. A system tracking individual items in inventory would decrease the amount of goods kept past expiration dates. To implement tracking of expiration dates on these items in SAP may require hand entry or bar coding. Utilities and ASD will work jointly to determine if a new field in the SAP inventory system can be added to track expiration dates from department locations.

ASD

It should be noted that Stores staff does date and color code items on shelves so that the oldest items are pulled from inventory. Again, this is an important area needing ongoing inter-department cooperation to manage goods appropriately.

Attachment C

The Utilities Department has not managed its meters and transformers using an inventory management system with sufficient controls

Utilities

There are two reasons to implement a centralized inventory management system: 1) to prevent the unauthorized use, physical deterioration, or theft of property, and 2) to manage the inventory in the most cost effective manner. The majority of the \$2.5 million of materials managed by the Utilities Department that are not in the warehouse are transformers, poles, switches, and meters. These materials have an extremely low risk of theft. They are specialized goods that have no functionality or resale value outside of utility use and for the most part are heavy and bulky and cannot be transported without a flat-bed truck and crane. In addition, these materials are designed for exterior use and are not subject to deterioration from the elements and long-term storage. A significant number of transformers are stored for the sole purpose of emergency repairs.

The Utilities recognize that efficiencies could be gained through better management of its inventories. It is unclear, however, whether these efficiencies will result in significant savings to the City. The management of transformers and switches has been delegated to the Utilities Department historically because these items required ordering from 4 months to 1 year in advance of delivery. Because of the long-lead time required for ordering, an engineer has been assigned to manage the transformers and another engineer has been assigned to the switches. Each engineer manages the specifications, ordering, receipt, testing, and payment for the equipment, and enforces manufacturer's warranty claims.

The inventory and management functions not currently handled in SAP could be added, but implementation of these changes would require extensive and costly modifications to the system. These changes would entail: inventory ordering, testing, and tracking procedures evaluated by the engineers and the field crews. Staff recommends that a cost benefit analysis be performed prior to implementing changes to the system to determine if there are sufficient benefits to justify the expense of implementing a centralized inventory system.

The discrepancies in the transformer counts cited in the audit report were due to a transition or change in the inventory management systems taking place at the time of the audit. The transformers have been managed in an Access Database and Utilities was in the process of transferring this function to the GIS system. Following the transition to the GIS system, all transformers were inventoried and accounted for.

It should be noted that transformer inventory is not updated on a daily basis because they are used for emergency replacements and are removed from inventory during off hours. The Electric Utility does conduct a monthly physical count in the yard and reconciles any discrepancies on a regular basis. Management of the transformers in the yard could benefit from the installation of an RFID system, so staff will evaluate the costs of a purchase and its benefits.

The Utilities Department supports creation of a consistent process for management of meters similar to those for managing other items stored in the warehouse. The majority of new gas and water meters are stored in the warehouse and released to the meter shops when requested. Due to limited space in the meter shops, Utilities will procure some large containers for meters that

Attachment C

are being staged for deployment. Utilities will also work with Stores to identify a storage location for electric meters.

ASD

To assure Council that meters and transformers are accurately recorded in the financial system and statements, it is important to explain their treatment. Meters and transformers are considered to be capital assets (as opposed to inventory) and, as such, are capitalized and depreciated over their useful lives. In total, the City owns over 3,000 transformers and all were recorded as capital assets at time of purchase. The transformers rotate in and out of service over the course of their lives, but only the acquisition and disposal activities are recorded in the capital asset system. This is standard accounting policy for the industry and is appropriate treatment from a financial accounting perspective.

The Public Works Department has not used the City's SAP inventory system to manage at least \$773,000 in materials, including emergency replacement parts at the RWQCP

Public Works

Public Works staff will work with ASD to evaluate including non-stock inventory in SAP versus currently keeping track of it manually. If SAP is upgraded to allow inclusion of non-stock inventory, Public Works will work with ASD to add these materials into SAP. In the meantime, the department will maintain and improve its records of non-stock inventory for the following:

- Long lead-time repair parts expensed to the Wastewater Treatment Fund
- Raw sewage screening presses
- Specialty sewage sludge incinerator fire bricks
- Industrial combustion air fans for the sewage sludge incinerator
- Activated sludge ceramic air diffusers
- Air pipes for the activated sludge
- Extra pipe fittings
- Sludge and sewage pumps

The emergency repair parts listed above are high value and low turnover. They have a very low risk of theft, and it is unlikely they would be deemed to have any value outside the context of a wastewater treatment plant. These items are on hand for the life of the equipment (typically 10-50 years). It is possible that the repair parts go unutilized for the life of the equipment, but the repair items are needed immediately if machinery breaks down in a 24/7 operation that involves health and safety issues for the City.

The Regional Water Quality Control Plant (RWQCP) Warehouse is small and incapable of storing a large number of items. Some non-stock equipment is kept at the RWQCP warehouse for easier organization and access by forklift, but there is limited space there as well for additional non-stock inventory. As a consequence, large non-stock items (e.g., the incinerator refractory bricks and sewage incineration fans) are stored in a large area under the fixed film reactors known as the "towers." The towers are unlocked facilities, though they are not accessible to the public.

Attachment C

Some areas of the plant are home to containers (i.e., steel storage shipping style container) that have been used recently to house non-stock inventory. This has allowed staff to better organize and de-clutter the towers and main water quality warehouse. Moreover, non-stock inventory is closer to the treatment process where it will eventually be installed. All non-stock items are stored in a sheltered area for protection against the elements and they sit ready for preventative maintenance and potential corrective repairs.

The \$773,000 in estimated non-stock inventory is expensed to the wastewater treatment fund and is stored for long periods as emergency and corrective repair parts. PWD will work with ASD staff to determine the appropriate accounting methodology for non-stock items.

The Information Technology (IT) Department has not used the City's SAP inventory system to manage at least \$919,000 in materials at the MSC warehouse

Information Technology

Staff agrees that the current manual Equipment Delivery Log system to track the inflow and outflow of equipment is not optimal. An SAP solution utilizing material reservations is now being implemented for the release of laptops, monitors, and other frequently purchased IT equipment. A procedure is also being put in place to ensure that the MSC warehouse will only receive IT goods for which material reservations are made.

Since the Auditors conducted their review, staff determined on December 10 that of the \$919,000 of IT equipment at the MSC warehouse identified in the audit, an estimated \$300,000 worth of monitors, laptops, desktops, and other equipment were being stored at the MSC warehouse awaiting the opening of the Mitchell Park facilities. Another \$17,000 worth of mobile data equipment for police vehicles was awaiting installation. An estimated \$137,000 of the \$919,000 identified from Purchase Orders was for warranties and licenses which are not physical items stored at the warehouse. All other goods valued at \$465,000 have been withdrawn for operational purposes. The inflow and outflow of IT equipment is fluid as most equipment is on a standard replacement schedule and the demand for IT equipment is high.

IT has requested and PW will install a cage at the MSC warehouse to separate IT equipment from other goods and foot traffic. It should be noted that no individual can walk through warehouse storage areas during regular hours unless accompanied by warehouse personnel. To improve security in the storage room at City Hall, IT worked with Public Works to establish badge access to the door entry, a ceiling-height gate to secure the specific IT area, and badge access to the gate.”

ASD

To verify that laptops, desktops, monitors and other items are accurately recorded in the financial system and statements, staff is providing the following explanation. If these items are over \$5,000, they are considered to be capital assets (as opposed to inventory) and, as such, would be capitalized and depreciated over their useful lives. As stated in the City's fixed asset policy, those assets that have a cost below \$5,000 on an individual basis are not capitalized, but rather are expensed at the time of purchase. Since these items were below the \$5,000 threshold, they

Attachment C

were appropriately recorded as expenditures when they were purchased. As such, there is not a material misstatement in the City's accounting records.

Finding 2: ASD should improve controls to ensure the accuracy of inventory at the MSC and RWQCP

Recommendation:

- 3. ASD should update and enforce inventory count policies and procedures to help ensure consistent and accurate inventory records. The update should at minimum require blind inventory counts, sufficient documentation of counts and adjustments, and appropriate segregation of duties. ASD should consider implementing controls included in the GAO publication titles "Executive Guide Best Practices in Achieving Consistent, Accurate Physical Counts of Inventory and Related Property"**

ASD

ASD already has implemented several of the above recommendations' components. It has, for example, instituted blind counts. It is important to note that the MSC warehouse has a relatively small staff half of which are used to deliver mail, goods, packets, and transport library books throughout each workday. Due to budget reductions in prior years, 1.0 FTE was reduced at the MSC warehouse and 1.0 FTE reduced at the RWQCP. Segregation of duties is difficult with limited staff and multiple responsibilities. Nevertheless, ASD will determine what improvements can be made within existing staff levels and which will require additional FTE.

The Auditor correctly points out a higher error count at RWQCP. Part of the error found is attributable to items that have been expensed, are in excess of project needs, and are housed at the site. Held for future replacement needs, these items were not entered formally into the inventory system. ASD will work with the departments and the SAP business group to avoid this issue and to improve counts. Other items, such as a rebuilt Maxon valve, fall into the uncounted category of stock as well. While staff agrees that such goods should be tallied in inventory, this example demonstrates an honest effort to maximize use of existing resources and maintain parts for emergencies.

Public Works

The RWQCP is a 24/7 operation with a high level of liability and risk to health and safety should processes and equipment not work properly. Staff requires access to parts, supplies, and equipment at a moment's notice. The RWQCP non-stock inventory at the RWQCP is exclusively sewage treatment equipment. These items are specialized industrial equipment. While they have high value, they have no functionality or resale value outside of the plant. The risk of loss from theft of this equipment is slight and an important point when evaluating the level of needed inventory control, storage policies, and up-to-the-minute inventory accuracy. PWD staff will work with ASD to evaluate options to improve inventory controls and accuracy at the RWQCP without impacting critical operations. Additional staffing may be required resulting in increased costs to the City and our partners. PWD will work with ASD to evaluate the cost and benefits of adding staff.

Finding 3 – Inventory records do not evidence accountability for all inventory transactions.

Attachment C

About \$1 million in inventory was issued without SAP reservations, which should be used to document and evidence the need and authorization for inventory transactions.

Utilities

Utilities supports the use of a reservations system designed to meet the needs of field personnel. Maintenance or capital improvement work that is planned in advance can conform to procedures stemming from a reservations system. Conversely, emergencies and urgent needs at the job site (which may be prompted by unanticipated field conditions) require materials on short notice.

If a system can be established that allows quick field entry into a reservations system, the amount of materials pulled without reservations could be either largely or completely eliminated. An analysis should be performed to determine if a system to allow quick system reservations can be implemented cost effectively and in conjunction with the SAP system.

Alternatively, a stand-alone system can be developed as long as the parameters for such a system and its use are pre-determined and consistent with how the balance of the City's inventories are handled. Furthermore, if the City decides to replace SAP with another system, it would make sense to delay the purchase and implementation of a system compatible with SAP, and instead, incorporate inventory management requirements in the scope of work for a new replacement system.

ASD

As Utilities states above, the reservation system is used, but there was a need for what is termed "un-planned goods" which was a requirement of Utilities when SAP was implemented. If field crews need items that were not part of the original reservation, they come to the MSC, provide a job number which is entered into SAP, and withdraw items that are then charged to the work order. There is no new reservation generated but the items are charged accordingly and can be tracked in SAP.

Segregation of duties has not been established at either the RWQCP or the MSC warehouse locations.

ASD

As stated under Finding 2, there is one storekeeper assigned to the RWQCP, a 24/7 operation, and four FTE at the MSC warehouse. Prior to a series of budget reductions, each operation had an additional 1.0 FTE. To achieve best practice segregation of duties, as well as other functions, additional FTE would be required at the RWQCP and potentially at the MSC warehouse as well. The warehouse Supervisor has implemented segregation of duties to the extent possible at the MSC where entering and posting duties are now segregated.

Attachment C

Public Works

Public Works supports ASD with updating policies and procedures, conducting blind counts, and any improvements to custody, counting, and inventory adjustments. The department recommends, however, that the RWQCP warehouse should continue to operate as an open warehouse with paper based reservations entered retrospectively. Currently, there is one storekeeper present at the warehouse and this allows a reasonable level of control. Due to budget reductions several years ago, staffing at this warehouse fell from 2.0 to 1.0 FTE. Changes to current operations will result in inefficiencies, increased personnel costs, and more administrative work for supervisors.

Staff estimates that at least an additional 3.0 FTE and other system changes would be needed to convert RWQCP operational practices to a closed warehouse system. Salary and benefits for the 3.0 FTE is estimated at \$371,000 annually and these positions would add incremental allocated charges to the Wastewater Treatment Fund. New positions and costs would have to be reviewed and shared with the partners.

With a closed warehouse, operational problems will occur when sewage treatment repair parts needed while electricians, maintenance mechanics, wastewater treatment plant operators, and supervisors waited in line to receive a complex set of parts and worked through the difficult administrative process of identifying repair parts from behind a counter.

For reasons of cost impacts, regulatory compliance, and a work efficiency viewpoint, Public Works respectfully disagrees with implementation of a closed warehouse reservation system. Nearly all of the repair work at the Water Quality Control requires the use of unplanned goods to keep the wastewater treatment plant working. Public Works is supportive of improving checkout procedures, accurate documentation for unplanned goods, and investigating other methods and systems that can be used to ensure consistent and accurate inventory records and prevent potential fraud.

Staff used a generic account in SAP known as “Stores1” that is accessible using a shared password to issue about \$8.5 million in inventory....

A generic account has been utilized at the warehouse. Staff will work with the SAP team to quickly implement specific accounts and to add a computer to establish better controls.

Finding 4- The City’s warehouses have significant quantities of unused or infrequently used inventory.

The Utilities Department and ASD did not ensure about \$130,000 in cable was used prior to transitioning to a new cable type, resulting in dead stock and potential waste.

ASD

In the past six months, Stores staff sent out slow moving stock reports to affected departments. Departments responded as to which items were no longer needed and justified those requiring continued storage. The warehouses recently have been pulling dead stock from the shelves. The

Attachment C

next step will be to return, sell, or recycle inventory. More frequent, periodic reports on aged goods will be sent to departments.

The Audit cites a low and decreasing turnover rate. The deletion of unused stock will partially address this issue. In addition, reports on minimum and maximum levels must be more actively used and analyzed to gauge the necessary level of inventory. To pare dead stock and optimize turnover or use of goods, consistent communication and coordination among departments will be necessary.

Utilities

The Utilities agree that more communication and more reports on unused stock are necessary. To effectively use and manage aging stock, all items must be entered in the SAP system so it can be identified and ordered through the reservation system. Regular, periodic reports must be generated to eliminate dead stock and Utilities will work with ASD to develop a timetable for ongoing reports and responses.

Public Works

Staff is cooperating with the review of potential dead stock by removing slow moving items and adjusting minimum and maximum inventory quantities to reflect current operational needs. An initial review process already has been completed with ASD staff on slow moving inventory. Early implementation of the Auditor's findings is expected to create a marginal amount of new space in the RWQCP warehouse. Public Works agrees with the statement that "improved management of inventory levels may lower dead stock and result in increased space available," but there will nonetheless remain an unabated need for the \$3.0 million warehouse expansion project identified in the RWQCP's Long Range Facilities Plan to address overcrowding issues in the existing warehouse.

Emergency repair parts are typically needed for the life of the sewage treatment equipment. Even with the absence of equipment failure for over 10 years, there is a need for specific items on hand that will prevent critical failures. As a result, there will be lower inventory turnover rates. Much of the RWQCP plant equipment is specialized sewage treatment equipment that cannot be obtained from local vendors such as Home Depot. This equipment is needed on a 24/7 basis and can require a long lead time (e.g., days to months) for delivery. Public Works supports managing and reviewing the slow moving stock on a more periodic basis to verify that items are needed.

Finding 5: The City has not properly secured access to the Municipal Services Center

Recommendation 5.9- Perform a Citywide physical access risk assessment in collaboration with the Utilities Department, Office of Emergency Services, the IT Department, and the Police Department in order to effectively identify, prioritize, and address access control weaknesses.

Public Works (PW)

Public Works is in the process of replacing the 40 year old hard key system for most exterior and critical interior doors with a card reader system eliminating the need to issue hard keys. The

Attachment C

cards are person specific and are issued to City staff and City approved contractors for access to their business areas. All City staff and contractors must pass a fingerprinting/background check prior to issuance of a card. PW staff will work with OES, IT and Police staff to identify potential weaknesses and continue to pursue recommendations for improvement such as installation of surveillance systems at critical entry ways should budget allow.

Recommendation 5.10- Develop policies and procedures to address the management of citywide physical security. Policies and procedures should address:

- a. Designation of roles and responsibilities to ensure physical security controls appropriately restrict and monitor access.**
- b. Management (administration) and proper use of the City's access control systems.**
- c. Processing departmental requests to grant or modify employees' physical access.**
- d. Granting restricted access to non-employees.**
- e. Ensuring access is timely modified or revoked when roles and responsibilities change.**

Public Works

In conjunction with the Public Works Department's American Public Works Association (APWA) accreditation process, staff will review and revise current policies and procedures for City facility security along with developing new policies and procedures where none currently exist. The procedures will document roles, responsibilities and processes for on-going system maintenance.

Recommendation 5.11- Configure the fleet access control system to support the City's security goals and objectives or determine if the AMAG Technology Inc. Symmetry Security Management System should replace it.

Public Works

Prior to the audit, PW staff was in the process of converting the Fleet Data system over to the AMAG access control system primarily because the vendor support for the old fleet system has been virtually nonexistent. Additionally, it has not been until very recently that the AMAG technology access control system had the capability to support the vehicle entry system. The complete transfer of all vehicle access to the AMAG technology control system should be done by the end of the fiscal year. The AMAG technology access control system will be able to track vehicles entering the yard and produce required reporting.

Recommendation 5.12- Review and update AMAG Technology Inc. Symmetry Security Management System access authorization records to ensure access card holders can be uniquely identified. Access cards (especially generic or group cards) should only be assigned with a documented and approved business need.

Public Works

Attachment C

PWD staff has initiated review of the current authorization records and has updated/removed some records already. Staff will continue to ensure that card holders can be identified and generic or group cards are not issued unless there is a unique business need. PWD staff will update the existing Access Request Form to include a more comprehensive section requiring hiring managers to explain the business needs of an employee for the requested access and/or documenting the need for generic or group card issuance.

During the audit, a list of people having access to the MSC warehouse was found to have multiple inaccuracies. The Warehouse Supervisor met with Public Works to review the list and all unauthorized personnel were removed from the system. In the future, staff from each department will meet semiannually to review the list of staff seeing access to the MSC warehouse. The Warehouse Supervisor will approve the final list.

Recommendation 5.13- Assess the adequacy of records of individuals assigned keys and take necessary corrective actions to ensure the accuracy and completeness of the records. The Public Works Department should identify and prioritize replacement or rekeying of locks for high risk areas if records do not identify who is in possession of the keys or if the keys issued were of the type that can be duplicated.

Public Works

PWD staff will review physical key records and update them to reflect the current issuance of keys. Prior to the audit staff began replacing the City's 40-year-old key system with a new Schlage Primus key system, adding card access readers to key locations, and adding cameras in specific locations improving security throughout the City. In conjunction with review of City security with Office of Emergency Services (OES), IT and Police personnel, PWD staff will identify high risk areas, evaluate the number of access keys issued and reissue new keys if it is recommended.

Recommendation 5.14: Improve physical security at the City Hall storage area. Appropriate actions include, but are not limited to, enforcing appropriate key or card access controls and securing areas that have inadequate fencing.

Public Works

Since the audit, Public Works staff added card access control to the storage area door, added card access control to the IT cage inside this room, and extended the IT cage fence to the ceiling.

Conclusions

Overall, City staff believes it has made conscientious efforts to preserve and safeguard the goods it purchases for operating and capital needs. Staff at the warehouses take their work seriously and are open to improvements which is one of the reasons the City Auditor was asked to help review current practices. Line departments have a primary responsibility to maintain services for the health and safety of the public, but acknowledge as well that efforts to improve inventory control are necessary. The flow of communication and coordination among the departments needs improvement.

Attachment C

Staff acknowledges lapses in keeping up with best practices, but believes this is primarily due to subpar staffing, the press of business/project needs, and the tendency to defer to those needs. Moreover, in its efforts to be cost conscious (rehabilitating equipment and saving excess, unique material), some best practices (e.g. high turnover of inventory, precise counts) have been somewhat overlooked.

Staff will explore further use and improvement of SAP and other existing and new systems to close risks cited in the report. We will measure SAP capabilities and the costs to implement them against other systems. New systems such as Radio Frequency Identification (RFID) or bar coding will be evaluated with IT assistance to better track inventory, especially those items such as utility poles which are not located in or near one of the warehouses.

Improvements to inventory control cited by the Auditor will cost money, either through the addition of personnel or to modify or purchase management systems. These costs will be assessed and brought to Council's attention as it works to prioritize and allocate limited City resources to other needs.

Finally, staff appreciates the Auditor's work on this report. The findings are useful to improve the tracking, optimal use, and safeguarding of City assets.



FINANCE COMMITTEE FINAL MINUTES

Regular Meeting
Tuesday, February 18, 2014

Chairperson Berman called the meeting to order at 7:14 P.M. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Berman (Chair), Burt, Holman, Kniss

Absent:

Oral Communications

None

Agenda Items

1. Review of Long Range Financial Forecast for Fiscal Years 2015 to 2024.

Walter Rossmann, Office of Management and Budget Director, reported that the Long Range Financial Forecast (LRFF) was the first step in planning the Fiscal Year (FY) 2015 Budget. It allowed Staff and Council Members to understand the long-term results of past decisions and to look forward to the next ten fiscal years. The LRFF was not a prediction or a commitment of resources; rather it was a reasonable snapshot of a moment in time based on available data. The General Fund Operating Margin was the surpluses and deficits resulting each fiscal year. The General Fund Net Operating Margin was a year-over-year comparison of the surpluses and deficits. For FY 2015, Staff projected a surplus of \$1.3 million. The cumulative surplus over ten years was \$38.1 million, assuming the Council funded the Budget Stabilization Reserve (BSR) at the target level of 18.5 percent. Given the needs of the organization, he assumed the City would spend its resources every fiscal year, which was the Net Operating Margin. In FY 2016, the FY 2015 surplus would not be available if the Council chose to spend those funds. Therefore, the surplus of \$4.4 million in FY 2016 was reduced immediately by \$1.3 million. As surpluses were spent, the year-over-year change would decrease. The City would alternate between slight surpluses and slight deficits. It was important to consider the long-term outlook. In the outer years, the City seemed to gain some surpluses; however, the

FINAL MINUTES

majority of the cumulative surplus of \$7.6 million was actually \$5 million in the final three years of the LRFF. Staff began building the FY 2015 forecast by assuming the same service levels as in FY 2014. The FY 2015 LRFF did not include ongoing labor negotiations. Any agreement beyond the 2 percent salary increase contained within the LRFF would impact the surplus. Funding the healthcare long-term liability could impact the LRFF. Assuming control of the Palo Alto Airport could have an impact on the General Fund, because the Airport Fund could not sustain expenditures with revenues in the first few years. The LRFF also did not contain information regarding third tier pensions. As more and more employees moved to the third tier, the change would have a positive impact long-term on the LRFF. Staff did not know if the City would be exposed to the Healthcare Federal ExciseT. The California Public Employees' Retirement System (CalPERS) indicated it would set plans in such a way that employers would not bear the tax. In addition, the LRFF did not include additional Transient Occupancy Tax (TOT) revenues from new hotels. The Golf Course Reconfiguration Project was not fully included in the LRFF. The City's acquisition of the Post Office and the potential provision of fire services to Stanford University could impact the General Fund and LRFF. Any economic downturn could also affect revenues. The local economy in Palo Alto had improved substantially. An improved economy created problems related to parking and provision of services. Based on trends, underlying data, and revenues received through December 2013, Staff projected any revenue expected in FY 2014 as well as built the projections for FY 2015. Once FY 2015 began, Staff primarily reviewed the compound and/or growth rate and made reasonable adjustments based on underlying data. Property tax revenue showed a steady increase. Some of the recent spike in sales tax was due to one company, and Staff attempted to adjust for that. That adjustment was the reason for the projected downturn in FY 2015. The Utility User Tax (UUT) grew very slowly because it depended on consumption and costs of consumption. The TOT increased when new hotels opened, then tapered off to a regular growth rate. Staff believed the amount of Documentary Transfer Tax received was above the norm; therefore, Staff projected a slight decrease in FY 2016. In projecting major expenditures, Staff reviewed one-time adjustments and salary increases. Beyond FY 2015, Staff assumed a 2 percent annual growth in salaries; CalPERS projections; an 8 percent annual growth rate for healthcare costs; and a 2.5 percent Consumer Price Index (CPI) increase. The CalPERS contribution rate for Public Safety Employees was projected to be 40 percent in FY 2015 and 59 percent in FY 2023. The contribution rate for Miscellaneous Employees increased by 56 percent in the same time period. The rates did not include any assumptions regarding third tier pensions. The alternative model included funding for a Public Safety Building. Issuing Certificates of Participation (COP) in FY 2016 to fund approximately \$34 million for a Public Safety Building would translate to

FINAL MINUTES

approximately \$2.5 million in debt service. The projected surplus of \$4.4 million would decrease to \$1.9 million. If TOT revenues were utilized to fund a Public Safety Building, then the net operating margin for the alternative model varied between slight surpluses and slight deficits. Staff projected an additional surplus for FY 2014 of \$5.9 million, primarily driven by higher than anticipated revenues. The LRFF assumed technical adjustments for rent charge increases, Stanford fire service decreases, and such items. Not included in the projection was any recommendation from the City Manager regarding adjustments to the FY 2014 Budget.

Chair Berman introduced the members of the Finance Committee (Committee).

Vice Mayor Kniss noted economic downturns were unpredictable, and the City experienced two incredible downturns in the prior 15 years.

Lalo Perez, Administrative Services Director and Chief Finance Officer, explained that recessions historically occurred approximately every nine years. The Committee directed Staff to review compound annual growth for the prior 10 and 20 years to account for possible recessions. The range for the Budget Stabilization Reserve (BSR) was 15 percent to 20 percent with a goal of 18.5 percent. The City Manager had the discretion to recommend to the Council to transfer funds above 18.5 percent to infrastructure.

Council Member Holman suggested Staff include information regarding assumptions and their bases in the Staff Report.

Mr. Perez could make the information prominent and include the table of compound annual growth.

James Keene, City Manager, suggested Staff include a sensitivity analysis chart that could demonstrate the impact of a recession and the multiplier effect.

Mr. Perez felt including a sensitivity analysis chart for the top five revenue sources would be appropriate.

Council Member Holman noted property taxes increased steeply while Documentary Transfer Taxes remained flat. She inquired whether the two taxes should be relational.

Mr. Perez explained that Staff noticed a high percentage of properties assessed at \$600,000. As those properties sold, they most likely would be reassessed at market value. However, homeowners were not selling their property; instead, they were renting their property.

FINAL MINUTES

Joe Saccio, Assistant Director of Administrative Services, indicated Staff increased revenues to approximately \$7.4 million in FY 2014. After FY 2016, Staff did not increase the Documentary Transfer Tax by the historical compound annual growth rate. In FY 2016, Staff believed revenues would revert to the mean and decrease to \$6.6 million. Staff attempted to reset the base amount in order to have a realistic projection.

Tarun Narayan, Management Specialist, added that the Documentary Transfer Tax was one-time revenue unlike property tax.

Council Member Holman inquired whether TOT was based on the current rate.

Mr. Saccio reported the TOT projection was based on the current rate of 12 percent.

Council Member Holman requested Staff comment on the reliability of the UUT projections.

Mr. Saccio indicated Staff assumed small or no increases in water, gas and electric rates in preparing the LRFF. Depending on usage, revenue would remain relatively flat. With respect to the telephone component of UUT, Staff did not have good data regarding potential increases. The general view was that the UUT would remain flat with perhaps some modest increases.

Council Member Holman asked if Staff had an update regarding phone usage and related taxes.

Mr. Saccio responded no.

Council Member Burt stated residents had reduced water and electricity consumption on a per capita basis. He asked about gross consumption as a City with a population increase.

Mr. Saccio utilized the Utility Department's five-year forecast in compiling the LRFF. The Utility Department's forecast included consumption factors.

Mr. Perez added that the Utility Department would provide an update regarding rates at the Finance Committee's (Committee) April 15, 2014 meeting.

Council Member Burt remarked that the rate of increase for UUT was higher than he would have assumed based on commodity assumptions.

FINAL MINUTES

Mr. Saccio would review the matter. Anticipated rate increases would need to be factored into increases.

Council Member Burt recalled that drought conditions were a driver toward permanent efficiency with respect to water consumption. He suspected that water consumption would be lower in 2024 than the projection.

Mr. Keene believed the City's method for pricing water was not appropriate as fixed costs for delivering water were built into the rate. Large increases in water rates were planned for the next five-year period. He presumed the increases were included in the projection.

Council Member Burt commented that water rates would level off in the next few years with completion of the Hetch Hetchy rebuild. Remaining increases could account for much of the projected increase.

Mr. Perez reported the Committee previously directed Staff to provide benchmarking in comparison to cities similar to Palo Alto. Utilities Staff would report on that at the April 15, 2014 meeting.

Mr. Saccio noted after 2015-2016 electric increases ranged from 3.6-6 percent, water increases from 3.8-7 percent, and gas increases around 1-2 percent.

Council Member Burt asked if that was per annum.

Mr. Saccio indicated the increases ranged over that period. He did not have a per annum percentage of increase.

Council Member Burt inquired about the number of years in the time period.

Mr. Saccio answered through 2023.

Council Member Burt calculated a rate increase of slightly more than 0.5 percent per year over eight years.

Chair Berman asked if that increase applied to water rates as well.

Mr. Saccio reported the high range was 7 percent from 2016-2017 to 2017-2018 for water rates with a lower percentage increase of approximately 3.8 percent.

Council Member Burt inquired whether TOT revenues from three new hotels were assumed in the LRFF and whether those funds were dedicated to a Public Safety Building.

FINAL MINUTES

Mr. Narayan noted TOT revenue from a total of five hotels was included in the LRFF.

Council Member Burt commented that dedication of TOT revenue to a Public Safety Building was considered in the alternative model.

Mr. Saccio added that Staff provided the Infrastructure Committee with a lower number for new hotel revenue to support infrastructure than what was contained in the LRFF.

Council Member Burt inquired about the amount Staff utilized for debt service.

Mr. Saccio explained that beginning in FY 2017 Staff expected to receive almost \$700,000 more than identified funds for debt service support.

Council Member Burt asked if Staff anticipated 30 percent more income from new hotels than the amount budgeted for debt service.

Mr. Perez reported the market changed as a result of municipal bankruptcy cases; therefore, interest rates may not be the same as anticipated. The City's rating could be different, and Staff wished to be cautious.

Council Member Burt noted the LRFF utilized CalPERS' official position of a 7.5 percent rate of return. The Committee may want to discuss relying solely on CalPERS projections; calculating and utilizing a more conservative projection; or not paying down unfunded liabilities.

Mr. Perez reported Staff was discussing those topics with the Chief Actuary Officer at CalPERS and requested CalPERS provide options for agencies. If CalPERS provided options, then Staff could present those options to the Council. CalPERS was listening to Staff and others.

Council Member Burt believed long-term infrastructure liabilities had revenues that offset expenses. If the City purchased the Post Office, avoiding high lease rates would offset the expense of the capital cost and renovations. If the City could eliminate the cost of the covenant not to develop at Cubberley, then it could set aside \$2 million a year toward capital expenditures.

Mr. Perez agreed that avoiding the cost of leases could pay for the debt service for acquisition of the Post Office. Renovating the Post Office would require a couple of years; therefore, the City would have two years of debt service with no income. Staff was reviewing options for purchasing the Post Office, including a cash purchase.

FINAL MINUTES

Chair Berman asked if cash would be withdrawn from the BSR for the Post Office purchase.

Mr. Perez did not want to utilize BSR cash as a first option, but would suggest the use of Stanford funds and Infrastructure Reserve funds. Utilizing those funds would then place limitations on other projects.

Mr. Keene suggested Staff could include in the LRFF some strategic scenarios on a number of issues to contrast the status quo with alternatives. That could be helpful for the Council in speaking to the community about priorities or choices. He asked if the LRFF included increased maintenance for Cubberley.

Mr. Perez indicated the LRFF did not include Cubberley maintenance on the operating side.

Mr. Keene reported many drivers were not included in the LRFF, because the City did not have a plan to make the ongoing investments. Staff estimated the ongoing deficit for unfunded maintenance at Cubberley to be \$16-\$17 million, and that amount would continue to grow. He inquired whether Staff had a forecast for the Airport.

Mr. Rossmann answered no.

Mr. Keene stated the Airport was another example of shortfalls the City would have to consider.

Mr. Rossmann explained the Airport was not included in the forecast because it was a different fund. The Airport could have an impact on the General Fund.

Mr. Keene noted the City had many commitments with volatility and obligations. Demonstrating some of those in the LRFF would be helpful.

Mr. Perez added that some of the areas would become known within the next few months, and Staff could begin placing them in the LRFF.

Council Member Burt felt the \$2 million a year from the covenant not to develop at Cubberley could be utilized to reduce deferred maintenance costs. He requested a graphic representation of the accelerated maintenance of streets so the public could see the accomplishments. The amount of funds allotted for maintaining streets after the goal was accomplished would be more than the amount needed. Hypothetically, those capital improvement dollars could be reallocated to other needs while maintaining excellent

FINAL MINUTES

streets from 2020 onward. He did not believe that projection was included in the LRFF.

Mr. Perez concurred and would provide a projection as part of the Proposed Budget document.

Council Member Burt recalled the City's deliberate actions that resulted in the current financial circumstance. He inquired about the amount of a deficit had the City not made changes.

Mr. Rossmann reported the City would be paying approximately \$750,000 more today in pension benefits alone.

Council Member Burt felt the Council, community and Staff should see those numbers. He asked if Staff thought a deficit could be more than \$10 million.

Mr. Saccio agreed that the City positioned itself through reductions and retirement plans to save a great deal of money.

Council Member Burt requested a rough calculation of the amount of a deficit.

Mr. Perez could provide a point in time number from a few years ago.

Council Member Burt remarked that the Council was proceeding with much of the infrastructure backlog. The City was moving in the direction of exceptional services and strong infrastructure.

Chair Berman inquired about hiring a consultant regarding property tax and Proposition 13.

Mr. Perez indicated Staff was considering other data, because people were holding their homes. The GIS map contained permits obtained for particular property, and Staff wanted to add the assessed valuation. Staff was attempting to obtain additional information to have more data for projections.

Mr. Narayan explained that Staff could utilize data such as the number of residential properties valued at less than \$600,000 and a five-year history of residential property sales to refine projections for Documentary Transfer Tax and property tax.

Council Member Holman noted that assessed value was different for remodel and demolition of residential properties. She was not confident that the Building Department was aware of situations where homes were technically demolished rather than remodeled.

FINAL MINUTES

Mr. Perez discussed that with Planning Staff. Having that information on the GIS would hopefully assist the Building Department.

MOTION: Chair Berman moved, seconded by Vice Mayor Kniss to forward the Long Range Financial Forecast to the Council as an Action Item.

Council Member Holman suggested the Motion incorporate the points Committee members made during the discussion.

Mr. Perez added that Staff would outline information they could not include in the LRFF and would provide that information in the Budget or further reports.

Vice Mayor Kniss commented that Proposition 13 changed everything.

MOTION PASSED: 4-0

Mr. Keene noted in 2009 27 percent of Palo Alto single-family residential properties were assessed at under \$200,000.

Vice Mayor Kniss felt that information needed to be woven into budget information.

Council Member Holman added that commercial properties were more extreme.

Chair Berman announced Agenda Item Numbers 2 and 3 would be heard together.

2. Inventory Management Audit
3. Staff Response to Inventory Management Audit

Houman Boussina, Acting City Auditor, reported that management requested the City Auditor consider the audit. The audit was conducted in accordance with the annual Work Plan. The objective of the inventory management audit was to determine if the City had adequate controls to ensure accuracy and completeness of inventory records, accountability for inventory transactions, and safeguarding of inventory. The City included inventory primarily at the Municipal Services Center (MSC) and the Regional Water Quality Control Plant. It was important to consider the areas outside the scope of the audit. Those areas included disposition and use of materials after leaving the City's warehouses; management of surplus or obsolete materials; staffing; inventory carrying costs; the appropriateness of stocking levels and reorder points; organization and condition of inventory; and a 2 percent surcharge policy. The audit risk assessment process identified the

FINAL MINUTES

other areas of risk. Although the areas were excluded from the audit, they could be addressed in future special advisory memoranda and/or audit reports.

Mimi Nguyen, Senior Performance Auditor, indicated Finding 1 found that at least \$4.2 million in inventory, more than half of total inventory, was not subject to consistent or adequate inventory management controls. The lack of reliable and complete inventory data could impair the City's ability to know the quantity, location, condition and value of inventory. Finding 2 found that inventory records were inaccurate for 20 of 182 materials in the sample, indicating an 89 percent accuracy rate overall for the \$3.6 million in recorded inventory. Inaccurate inventory records could result in financial misstatements and operational inefficiencies. Finding 3 found from January 1, 2007 through April 19, 2013 about \$1 million in inventory was issued without reservations evidencing the need and authorization. Also about \$8.5 million in inventory, about 58 percent of total inventory issued, was processed using a generic user account accessed with a shared password. In addition, Staff performed incompatible duties in managing and processing inventory. Controls ensuring accountability and transparency of inventory transactions reduced the risk of fraud and abuse and helped ensure materials were appropriately and timely procured and made available. Finding 4 found that more than 50 percent of the City's 4,383 stock materials, \$2.5 million in inventory, had not turned over in a one-year period. Inventory turnover decreased from 87 percent in FY 2007 to 64 percent in FY 2013. Inventory that did not move could indicate a waste of resources. Finding 5 found that there were a large number of cards granting access to the MSC and the MSC warehouse, including cards without adequate identifying information. Other security concerns were noted. Physical security controls were required to safeguard and protect the City's inventory and sensitive and strategic sites. As a result of the audit, the City Auditor made 14 recommendations addressed to the Administrative Services Department (ASD), Utility Department, Public Works Department, and Information Technology (IT) Department.

James Keene, City Manager, believed Staff's response could answer Finance Committee (Committee) questions.

Joe Saccio, Assistant Director of Administrative Services, acknowledged that management requested the audit and requested the Auditor review controls, policies and procedures. Staff could not find any material misstatements in financial statements. Staff implemented locked doors and gates and security cards to protect Utility, IT and Public Works goods. New containers and new storage units were provided at the Regional Water Quality Control Plant for storage of items outside the warehouse. Warehouse management

FINAL MINUTES

and department users were in the process of clearing aged and unused inventory for return or surplus sales.

Vice Mayor Kniss asked Mr. Saccio to include in his responses the systems Staff utilized.

Mr. Saccio reported that Staff did not utilize SAP for all items of inventory. Staff would utilize SAP for IT equipment stored at the warehouse. Other databases and systems were used to track transformers and meters. Staff would review SAP's current uses and review the costs and benefits of continuing use of SAP, enhancing SAP or using other software. The City had a decentralizing system for tracking and managing goods. He inquired whether he provided the information Vice Mayor Kniss sought.

Vice Mayor Kniss responded no.

Mr. Saccio reported that Staff accounted for the \$919,000 of IT equipment. At the time of the audit, the goods were not being tracked in SAP. That was an omission; however, goods were manually tracked. One solution was to incorporate identification of IT goods in SAP. The Auditor recommended blind counts, and that was implemented. Public Works would institute a card reader system and replace a hard key system. Staff purged users originally identified for entry into the warehouse to active users and only people who needed access to the warehouse. Staff needed to review all procedures and policies and to document all roles and responsibilities of everyone in the departments. Staff needed enhanced communication and procedures among all departments. Staff needed system modifications and enhancements, whether in SAP or other systems, to address issues raised in the audit. Staff would generate periodic reports for users of inventory, so they could have accurate information regarding inventory. The Public Works Department would implement physical security measures and coordinate with the Emergency Response Department. Staff worked to safeguard City assets within existing budgetary and organizational constraints. Staff acknowledged that improvements could and would be made. The Auditor noted that \$4.2 million in inventory was not recorded in SAP. That did not mean that the City lost \$4.2 million in inventory. More than \$900,000 in IT goods were stored at the warehouse, but were not recorded in the inventory system. Remaining items were accounted for in a different system.

Lalo Perez, Director of Administrative Services Department and Chief Finance Officer, explained that the City's practice for many years was to expense out some inventory items. When items were expensed out, they were not tracked in inventory. Staff wanted to track inventory in SAP if

FINAL MINUTES

possible; however, SAP might not be the most practical method for some areas of the City.

Mr. Keene noted that SAP was implemented in 2003 to integrate many different systems. The City underfunded the investment in SAP and training, such that former, parallel practices remained in use. Some problems would be simple to remedy. He suggested the various departments explain their reasons for doing things in certain ways and whether the additional cost to implement every level of control was worthwhile.

Council Member Holman did not find a Staff response to the disposition and use of materials after leaving warehouses. She inquired whether the levels of inventory were appropriate, given the dollar amount of inventory.

Mr. Perez requested the Auditor clarify disposition and use of materials.

Council Member Holman clarified that she wanted to know whether an item was utilized for a City project once it was checked out of inventory.

Vice Mayor Kniss asked if Council Member Holman wanted to know if Staff implemented a system to track each item.

Council Member Holman replied yes.

Mr. Boussina recognized this as an important element of safeguarding and appropriately using inventory. The audit stopped at inventory management. This was one reason Staff needed solid controls over the movement of inventory. Once transactions were recorded, Staff should know inventory was going out for an approved and authorized purpose and cause.

Mr. Perez reported some items could be found in a tracking system. For transformers, the Utility Department was required by regulatory mandate to track them. One of the challenges of using SAP was the checking in and out of inventory during repairs to equipment. Some items were not tracked and Staff did not know where those items would eventually be used.

Council Member Holman expressed concern over the lack of inventory tracking and control. She asked if levels of inventory were appropriate and if there was a definition of surplus.

Mr. Perez indicated there was a policy and procedure regarding surplus inventory. Surplus was an item no longer needed for City operations. Staff had to determine whether an item had a value or not. Based on thresholds for value, the determination of whether an item was surplus was made by the warehouse supervisor or Mr. Perez. In terms of inventory, Staff worked

FINAL MINUTES

with departments to identify inventory. As a result of the audit process, Staff was receiving better cooperation.

Mr. Boussina identified what appeared to be inventory, essentially materials that were stored but not placed into operation, along the side of the building. The inventory was open to the MSC yard and accessible. He understood the items were expensed and were accessible to trucks for reloading and restocking. The items were not subject to inventory management control. The audit team physically counted and valued the items. It was not practical to audit them in the same way as the areas in Findings 2-5.

James Allen, Water Quality Control Plant Manager, reported stock items in SAP were assigned to a specific work order when taken from stock. Staff could track the specific stock item to a specific corrective repair. Certain stock items, such as latex gloves and housekeeping supplies, were not tracked.

Council Member Holman agreed consumables were a different category.

Mr. Allen added that consumables were taken from City stock.

Council Member Holman reiterated her question regarding the level of inventory.

Mr. Allen stated that much of the wastewater treatment equipment was kept on hand in case of a corrective repair. That equipment may not be needed for 10-30 years. Recently dead stock valued at approximately \$21,000 was identified because of obsolete equipment. He did not believe that amount was excessive in terms of the entire Wastewater Treatment Fund. He believed the amount of inventory was appropriate.

Tom Marshall, Assistant Director for Utilities Engineering, noted the largest and most expensive item the department was holding was transformers. Transformers were needed to replace failures in the field and for new customer connections. A typical lead time to obtain a transformer was six to nine months, resulting in the need for a large inventory.

Council Member Holman was not sure that transformers and items for emergency repairs approached the amount of inventory in terms of dollar investment. An incorrect amount of inventory was a systemic issue. She was shocked by the number of access cards issued and the use of a generic account accessible by a shared password to issue \$8.5 million in inventory. She requested more information regarding warehouse expansion at the Regional Water Quality Control Plant prior to any money being spent. Her

FINAL MINUTES

overarching concern was the culture of the system; that Staff did not raise concerns before the audit was performed.

Mr. Saccio did not deny that the list of people with access was too great. During business hours, no one accessed the warehouse unless accompanied by a warehouse person responsible for inventory. Only a bona fide supervisor in charge of a specific project could enter the warehouse at night during an emergency. Some protections were in place to safeguard inventory. Staff did not believe many goods were being removed through theft.

Mr. Keene suggested department heads address practices that evolved within departments and became ingrained. The Chief Financial Officer (CFO) was frustrated by the pace of the integration effort and requested an audit. The audit was transparency on a management issue. There was not a systematic way to verify risks with the use of old systems.

Vice Mayor Kniss felt Staff provided more of a problem than an answer. If SAP was not sufficient or not operating correctly, it was the City Manager's problem. Clearly there were many problems and few, if any, answers. She was attempting to understand who was responsible for the outcome. Within six months, the Committee should hear Staff's detailed responses and solutions.

Council Member Burt heard a number of responses, but no answers. In 2007 the City had an annual inventory turnover of 87 percent, which dropped to 64 percent in 2013. Staff's responses did not explain what changed between 2007 and 2013. He inquired about changes in the respective departments that would account for a lower turnover rate.

Dean Batchelor, Assistant Director for Utilities Operations, reiterated that \$82,000 in inventory was unsecure and unaccounted for. The items were mostly truck stock pieces, nuts, bolts, washers, connectors. The highest limit item in there was \$165.

Council Member Burt noted approximately \$8 million in total inventory between Utilities and General Fund. He inquired about the amount of inventory carried by Utilities.

Mr. Batchelor answered approximately \$5-\$6 million. He reported \$2.1 million of inventory was transformers. Transformers were tracked on a monthly basis through Access programs, because of the testing aspects of it.

Council Member Burt asked if those were in place in 2007.

FINAL MINUTES

Mr. Batchelor indicated Utilities did not have as much stock and did not perform as many rebuilds in 2007.

Council Member Burt remarked that a lower turnover of inventory resulted in more stock. If there were sound operational reasons for deliberately higher stock, he would have put that in the report. He did not hear any reasons for needing more stock.

Mr. Marshall did not have an explanation for having more stock and less turnover in the warehouse. Utilities Staff could request ASD assistance to determine what was in the warehouse and why it was there. Typically Utilities Staff told ASD Staff which materials to stock and the number of items to be stocked.

Council Member Burt asked when Staff received the audit report.

Mr. Marshall responded December 2013.

Council Member Burt inquired about progress in understanding the reasons for a lower rate of turnover.

Mr. Marshall reported Staff was reviewing inventory in the warehouse to determine the items that needed to be stocked.

Mr. Allen noted the Water Quality Control Plant identified \$21,000 in dead stock. Those items were needed to repair the wastewater treatment plant and might be kept for 50 years or the life of the equipment.

Council Member Burt remarked that Staff was turning over inventory at a significantly slower rate and carrying more inventory today. Either some fundamental change in operational needs occurred or the City was carrying too much inventory because Staff was sloppy.

Mr. Allen reported Staff performed a complete review of all stock items and evaluated the number of items needed for each stock item.

Council Member Burt agreed that possibly the Water Quality Control Plant did not have a decrease in turnover. He inquired whether its turnover rate decreased.

Mr. Allen did not know. Some of the equipment did have a use, even if the resale value was low, and should not be discarded. That could contribute to the decreased turnover rate. If Staff included non-stock inventory, items that were expensed out, then the Water Quality Control Plant would have an even lower turnover rate. Turnover may not be a good method to benchmark the efficiency of the warehouse.

FINAL MINUTES

Council Member Burt inquired whether the methodology for determining turnover rate remained the same from 2007 to 2013. He did not find any information indicating changes in the methodology between 2007 and 2013.

Mr. Perez needed to provide better analytics. Staff could present that information when they returned to the Committee.

Council Member Burt inquired whether Staff analyzed inventory turnover by department.

Mr. Boussina indicated that inventory turnover was reported at a higher level in the report; however, he could break it out by department.

Council Member Burt believed that was a necessary first step in order to figure out where to focus.

Mr. Perez would identify the big ticket items versus general inventory ordered by all departments. Staff could provide specific details and factual numbers.

Mr. Keene commented that updating and reporting regarding the audit would continue. Staff was not in a position to work out all issues before presenting the audit. Working through recommendations, responses and solutions would take focus, time and effort. Staff's responses at the current time would not satisfy the Committee. Staff wanted the themes of Committee questions in order to respond to them at a later time.

Council Member Burt related his experience with inventory management issues in other organizations.

Mr. Keene noted a number of different solutions would be needed.

Council Member Burt felt metrics could be beneficial. One department could require a lower rate of turnover of materials by the nature of its work. Compiling a department-by-department baseline was one important measurement to establish the goal. He did not hear a Staff response regarding the use of technology beyond using or not using SAP. In industrial operations, technology had improved greatly. Once set up, new technology was easier to use than old methods.

MOTION: Vice Mayor Kniss moved, seconded by Chair Berman to recommend that Staff return to the Finance Committee within six months with the answers on how to correct the audit findings, incorporating measurements, detailing in an easy to understand way how the audit findings will be fixed.

FINAL MINUTES

Vice Mayor Kniss believed Staff's responses and solutions should return to the Committee. Clearly Staff had an idea of what they could do, but no clear idea of what they would do.

Mr. Saccio noted Staff provided an action plan to the auditor on each recommendation and timeline. Staff viewed responses to the audit as a work in progress.

Vice Mayor Kniss stated at some point solutions were needed.

Chair Berman inquired about a timeframe for providing the audit to the Council.

Mr. Perez recalled that in past actions the Committee accepted the report but conditioned it upon Staff returning with an update. The report would go to the Council and Staff would return within six months to provide a status update.

Chair Berman asked Vice Mayor Kniss if that action coincided with her intentions in the Motion.

Vice Mayor Kniss agreed with the plan. The audit may not be resolved in six months. Council Member Burt discussed the report aptly. Staff ought to be able to utilize technology for tracking inventory.

MOTION RESTATED: Vice Mayor Kniss moved, seconded by Chair Berman to direct Staff to return to the Finance Committee within six months with an indication of how the audit findings will be tracked or systematized so Staff will know what is in inventory; 2) to accept the Audit; and 3) forward the Audit to the full Council.

Mr. Keene asked if the audit would be forwarded to the Council.

Mr. Perez answered yes. It would be placed on the Consent Calendar.

Mr. Keene inquired about the Council's action with respect to the audit.

Mr. Perez reported the Council could accept the audit.

Mr. Keene did not wish to have a Council discussion if the Committee had a good direction for Staff.

Vice Mayor Kniss indicated the goal was for Staff to return to the Committee.

Mr. Keene reiterated that Staff knew the problem, but not the detailed steps to resolve it.

FINAL MINUTES

Chair Berman remarked that the City purchased SAP in order to integrate all departments. All departments should utilize the same solution. Obviously Staff did not know what inventory was on the shelves.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER 1) to have this Item go to Council under the Consent Calendar; 2) to include these Minutes when the Item goes before Council; 3) to have Staff respond within six months to the Finance Committee; and 4) to have Staff account for the level of inventory, the culture of responsibility and accountability, and the tracking and disposition of the materials posted at the warehouse.

Mr. Keene reported that technology could be utilized to implement the redesign of systems. The City could have some software capacity that was not being used. Staff was assessing the future of SAP and methods to support change efforts.

MOTION AS AMENDED PASSED: 4-0

Future Meetings and Agendas

Lalo Perez, Director of Administrative Services Department and Chief Finance Officer, announced the next meeting was scheduled for March 4, 2014. Staff would present the Emergency Medical Services First Responder fee proposal; and the Utilities Advisory Commission recommendation to adopt a Resolution establishing the Palo Alto Green Gas Program. The Agenda for March 18, 2014 would include the Mid-Year Budget; the Utilities Department organizational assessment; the local solar plan initiative; and disposition of cumulative Palo Alto Green revenue. He requested the meeting time for the March 18, 2014 meeting be moved up to accommodate the lengthy Agenda.

Council Member Holman was not available at an earlier time.

Chair Berman also was not available at an earlier time.

Vice Mayor Kniss would be available at the same or an earlier time.

Mr. Perez reported the meeting time would be 6:30 P.M. on March 18, 2014. On April 15, 2014, Agenda Items were proposed financial plans for electric, gas, and wastewater; Community Development Block Grants (CDBG); Human Service Resource Allocation Process (HSRAP); and a storm drain fee increase. Budget hearings would be held in May 2014.

Chair Berman inquired about the process for scheduling Budget hearings.

FINAL MINUTES

Mr. Perez explained that the Finance Committee (Committee) could change meeting nights if a Committee Member was not available. If that was not possible, then Staff would ensure the wrap-up meeting was scheduled at a time when all Committee members could participate.

Chair Berman asked how the schedule was determined.

Mr. Perez would send Committee members a proposed schedule and they would notify him of conflicts.

Adjournment This meeting was adjourned at 9:50 P.M.

CITY OF PALO ALTO
 POLICY, PROCESS, AND PROCEDURES
 FOR INVENTORY MANAGEMENT

EFFECTIVE DATE:	September 5, 2014	APPLICABILITY:	Inventory Management
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PURPOSE

The purpose of this document is to provide guidance to city staff by policy, process and procedures for the treatment of City inventory. They are the rules and methods of conducting business. The processes incorporate internal controls that help ensure the responsible use of public funds and efficiency of operations, including the safeguarding of assets, the reliability and completeness of information reporting, and compliance with laws and regulations.

WHY IS INVENTORY MANAGEMENT IMPORTANT TO THE CITY?

- ✓ **Responsible use of public funds.**
 - Are we purchasing what we need?
 - Are we using what we purchase?
 - Are we purchasing at the best price?

- ✓ **Operational efficiency.**
 - Do we have the materials we need to serve our customers?
 - Do we know what we have?
 - Are we managing what we have?

- ✓ **Accurate costing and accounting.**
 - Are the financial statements capturing the assets and costs correctly?
 - Are the costs being charged correctly?

LAWS AND REGULATIONS

Charter of the City of Palo Alto, Section 6 **Duties of City Manager:**

“It shall be the duty of the City Manager to have general supervision over all city property and equipment and its use for the public or by city employees.”

Municipal Code of the City of Palo Alto, 2.08.075 **Care of city-owned property.**

“Each department head and council-appointed officer shall be responsible for care and safekeeping of all city-owned property used by or in the custody of the department and shall take steps as necessary to ensure that the use or condition of said property does not incur legal liability or loss for the city or its officers and employees. The term "property" as used herein includes land, buildings, structures, vehicles, equipment, tools, furniture, supplies, money, securities, and components of the utilities system.”

Municipal Code of the City of Palo Alto, 2.08.150 **Department of Administrative Services.**

Attachment E

The Department of Administrative Services shall be under the control of a Director of Administrative Services who shall be accountable to the City Manager. The duties of the Director of Administrative Services shall be as follows:

- “To operate and maintain the warehouse and storage facilities of the city and such control records as are necessary for the proper inventory of stocks and supplies.”
- “To coordinate the warehousing of city-owned materials and disposition of city-owned surplus materials.”

BEST PRACTICES

The City of Palo Alto’s inventory policy guidelines and procedures are guided by the federal Governmental Accountability Office’s (GAO) Best Practices, which specify that an organization should:

- Know the quantity, location, condition, and value of assets it owns.
- Safeguard its assets from physical deterioration, theft, loss, or mismanagement.
- Prevent unnecessary storage and maintenance costs or purchase of assets already on hand.

POLICY

All city assets held in inventory, defined as a material or equipment replacement part (material) waiting to be placed into operation, must be:

- Identified, catalogued, and tracked.
- Managed using the City’s adopted inventory management system or a comparable inventory management system approved by the Administrative Services Department.
- Recorded accurately in the City’s accounting system.
- Safeguarded from physical deterioration, theft, loss, or mismanagement.

DEFINITIONS

Inventory: A list of material or equipment replacement parts that are stored and waiting to be placed into operation. These goods consist of those that are “valued” and treated as an asset on the balance sheet and those that are “non-valued” and treated as an expense. Each type is expected to be used on a future basis, either one time or periodically.

IT Goods: Equipment that IT is responsible for such as: laptops, desktops, monitors, and printers.

IT Consumables: Equipment that IT is responsible for and is valued at less than \$100 such as: mice, keyboards, laptop bags, and DVD drives.

Material Master: A record in SAP that describes a material or supply item. It is the central repository of information on materials in SAP.

Material Reservation: A requisition created for the withdrawal of stock item(s) from the Warehouse.

Non-valuation Stock: Non-valuation stock is tracked by quantities, not by cost or value. Non-valuation stock is entered as an expense in accounting immediately as it is received and is entered into SAP. . An example is computer equipment under \$5,000. By accounting policy, this equipment is expensed upon and is stored at the

Attachment E

City's warehouse until requested by IT. All computer goods in this category will be listed in SAP for tracking and stored for future use in the MSC Warehouse.

Purchase Requisition: Request made for Purchasing to procure a certain quantity of a material.

Point of Contact: Pre-identified individual for each Department responsible for the care and safekeeping of city inventory. For example, currently the Supervisor of Operations, in each Utility, who serves as that Utility's liaison between Stores, their Utility's Engineering, and Operations regarding product information and specifications.

Stock Inventory (or Stock): Inventory that is ordered regularly and tracked in SAP

Valuated Stock: Goods that have a value and are placed into inventory to be charged or expensed to departments, or capitalized as they are placed into operation or used for a capital project. Valuated Stock is treated as an asset on the balance sheet.

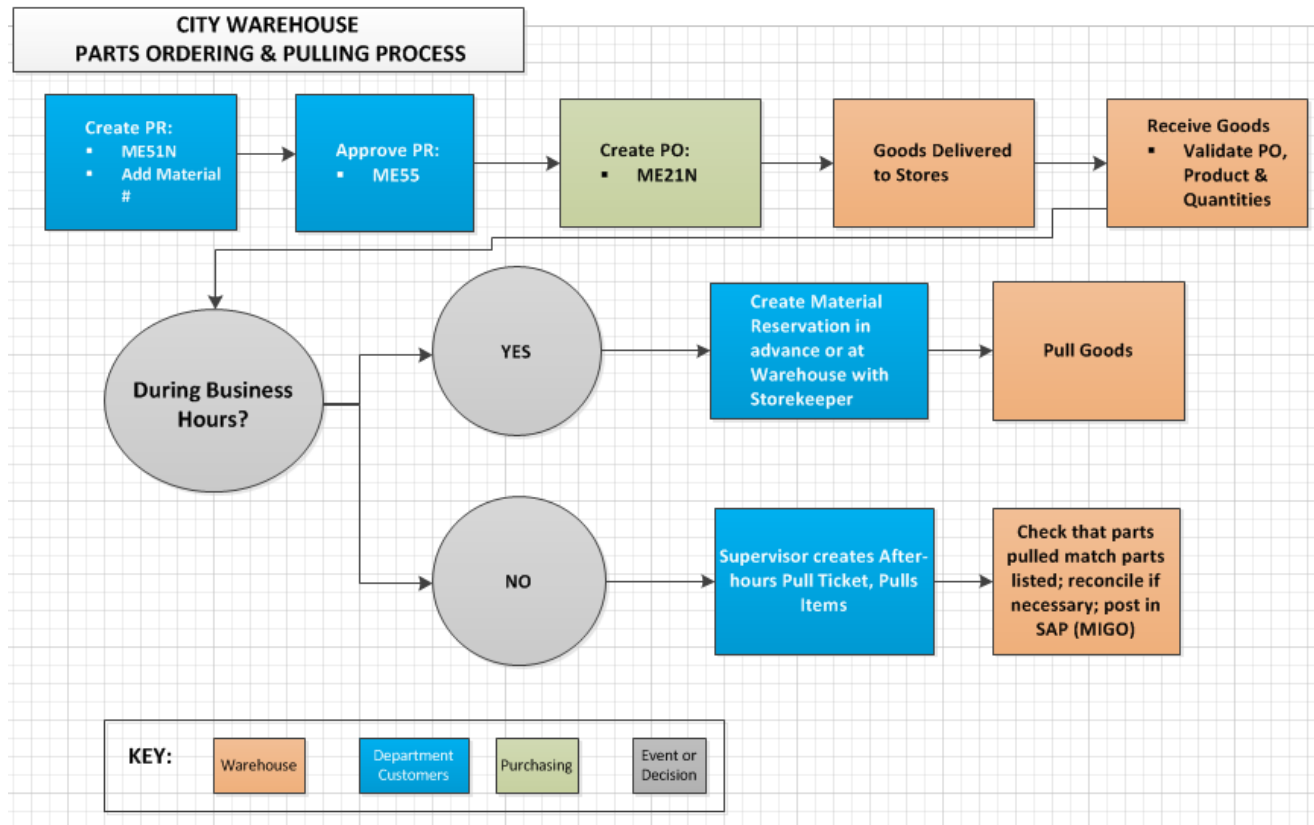
PROCESS GUIDELINES

1. One must first determine whether the material is city inventory, by considering the following:
 - a. Will the material be purchased or used again in the future?
 - b. Will the material be stored, rather than placed immediately into operation?
 - c. Is it important to know where it is and how much is available?
 - d. Will a customer or department be charged for the Material?

If answer to any of the above is "yes," then material should be treated as city inventory.
2. Identify if the Material can be managed using the City's adopted inventory management system.
 - a. All of the following materials are managed using the City's adopted inventory management system:
 - Current stock items in the Municipal Services Center (MSC) and Water Quality Control Plant (WQCP) Warehouses
 - WQCP Emergency Parts
 - IT Computers and Miscellaneous Equipment
 - Any materials that are not deemed "exceptions" (See page 5 of this document) that may be managed outside the SAP inventory management system.
 - b. See EXCEPTIONS section below for a list of materials categories that are not considered exceptions and may be managed outside the SAP inventory management system.
 - c. To qualify a material for management outside of the SAP inventory management system, the Department must identify why it cannot be managed in SAP and establish a comparable set of inventory controls for review and approval by the Administrative Services Department.
3. The Administrative Services Department will be responsible for City inventory managed within the City's adopted inventory management system. All Departments will be responsible for City inventory, within their respective area, managed outside of the City's adopted inventory management system. Purchasing and Stores staff are responsible for tracking all parts and materials until issued to departments. Once parts and materials are issued to departments, it is the responsibility of the receiving department to safeguard and appropriately place those parts and materials.

4. Overall process flow of material categories is summarized in Appendix 6.

HIGH-LEVEL WORKFLOW DIAGRAM



PROCEDURES

The following procedures are to be followed for all goods at City Warehouses.

1. General

- Stores and Purchasing will work with one identified “Point of Contact” per Utility and one for the WQCP.

2. Card Key Access

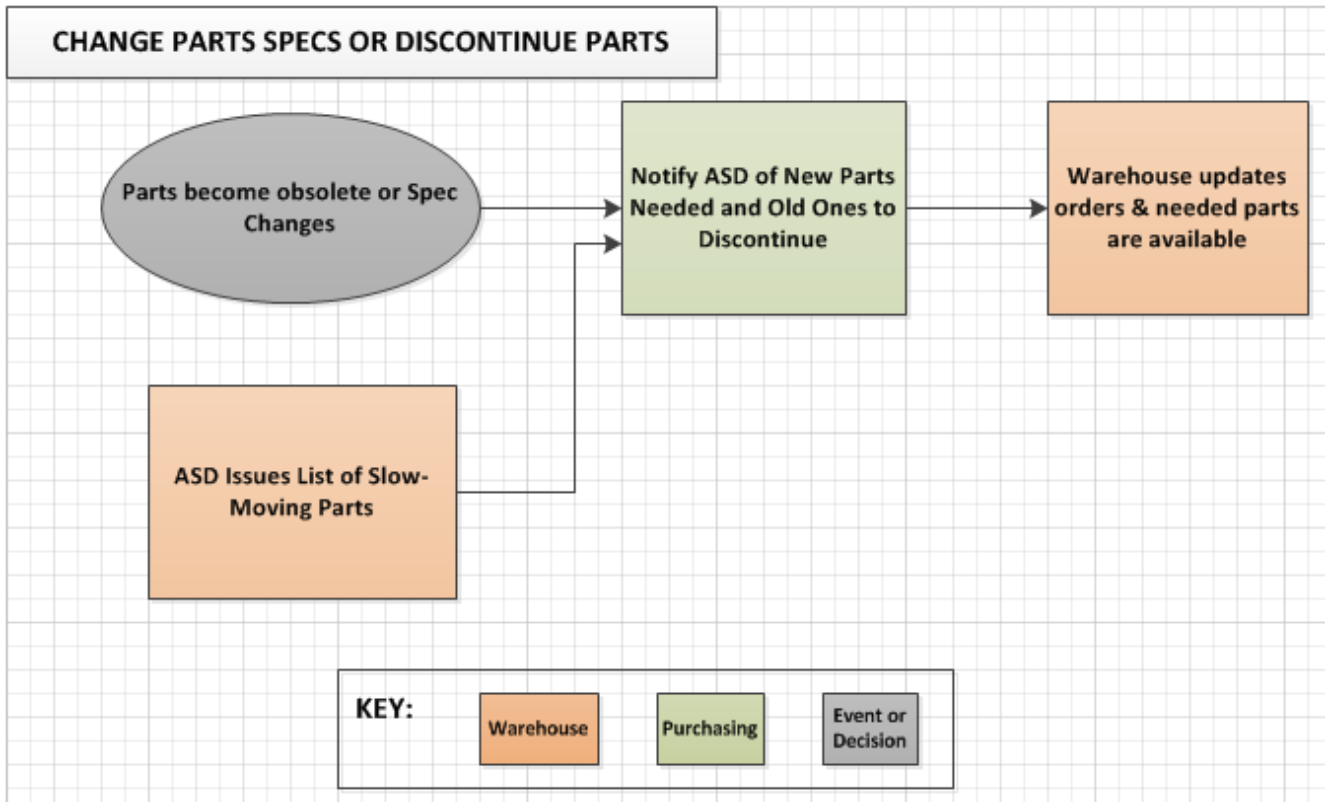
- Departments requesting card access to city warehouses will fill out a Security Card Request for Access Form found on U:Drive
- Forms are forwarded to the Public Works Facilities Maintenance Operations Manager (Facilities Ops Mgr) for review and approval.
- Facilities Ops Mgr will contact the Warehouse Manager for approval. Warehouse Manager will accept or deny the request based on the reason for requesting access.
- Facilities Ops Mgr will then enter into the system to activate card.
- Facilities Ops Mgr and Stores Manager will review and potentially revise the list of all card holders annually.

3. Materials Reservations

- a. All materials and supplies must be reserved in advance or at the counter on a walk-in basis. The Storekeeper will enter the relevant information into SAP and pull the requested parts from the warehouse shelves.
 - To submit a reservation, use MG21.
 - Stores staff executes ZQMM_MB25 for daily reservation pick list.
 - Stores staff pulls goods from pick list.
 - Stores staff performs Goods Issue via transaction code: MIGO
 - Enter: reservation number
 - Update quantity
 - Post reservation
 - System updates quantities
- b. When there is an after-hours emergency, authorized personnel may use his/her card to enter the warehouse, create an After-Hours Pull Sheet (See Appendix 1) listing the parts to be taken from the warehouse, and then pull the needed parts. The following morning, the Storekeeper will verify that the Pull sheet is accurate, and post in SAP.
- c. For IT materials valued less than \$100, Stores staff will receive equipment in SAP using transaction: MIGO.
 - IT consumables will be delivered within 2 business days to IT at the Civic Center A-Level.
 - Authorized IT personnel will sign delivery sheet upon receiving equipment and store in a secured, caged area.

4. Parts Specification Changes (see Summary Flow Chart on page 6)

- a. Stores will provide semi-annual lists of slow-moving goods, as well as inventory turnover data, to Points of Contact.
- b. Points of Contact will report back to Stores and Purchasing staff within ten (10) working days regarding goods that are no longer needed, goods that are needed in different quantities, and/or newly specified or needed parts.
- c. In the case of newly requested parts, parts to be discontinued, and special-order (one-time) parts, specific forms will be used (see Appendices 2, 3, and 4). These forms may be completed and signed online; for Utilities, they require approval by both Operations and Engineering Divisions.
- d. Specific instructions for locating and tracking parts in SAP may be found in Appendix 5.



5. “Non-Valuated” Stock and Use of Outside Containers

- IT equipment
 - IT goods that are valued at more than \$100 **and** are purchased in quantities of 10 or more are to be stored at the Stores as a non-valuated stock item.
 - All IT goods received at the Stores Warehouse must be stored securely in the cage designated for IT equipment only. No other goods are to be stored in that area.
 - Only authorized IT personnel are to request IT goods from the Stores Warehouse
 - Only Stores Warehouse personnel are to have access to the IT cage.
- WQCP
 - Parts ordered for emergency repairs or unplanned maintenance are designated “non-valuated stock” and stored in the Towers, outside storage containers, and/or WQCP warehouse.
 - WQCP staff will physically count non-valuated stock once per year and provide updated counts to Stores.
 - To pull parts from the towers and outside containers or to move parts between the towers and outside containers, use a “Non-Valuated Stock Pull Ticket” to document the request (see WQCP P&P Appendix 3) and return to Storekeeper for entry into SAP.
- Returned items from jobs
 - These items will be treated as non-valuated stock and stored, listed, and tracked in SAP.

6. Cycle Counts

- Warehouse Supervisor creates Cycle Counts for both MSC and WQCP using T-codes ZMICN
- MI21 is used to print the count sheets
- Staff does blind count of stock items on list

Attachment E

- d. Lead or Supervisor will enter counts into SAP using T-code MI04.
- e. Lead or Supervisor then runs report (T-code MI20) which shows any discrepancies in the count vs what is in SAP. The Supervisor or Lead then physically re-checks stock on-hand to ensure the correct counts are entered in SAP.
- f. After recounting stock in question the Supervisor or Lead can then make adjustments as needed before posting counts into SAP.

EXCEPTIONS

List of Exceptions

1. The following equipment is ordered by Department staff and not through Stores or Purchasing staff:
 - a. Electric Meters (pending results of report by City Auditor, expected September 2014)
 - b. Transformers
 - c. Certain specialized materials required for CIP projects (Stock items needed for CIP projects are ordered through Stores.)
 - d. IT consumables (valued at less than \$100) that are delivered to the Stores Warehouse must be delivered to IT at the Civic Center A-Level storage within 2 business days
 - e. Low-volume IT items, including servers, switches, and wireless access points. These are delivered directly to IT at City Hall.
2. The following equipment is ordered by Stores, but received and tracked by Utilities:
 - a. Electric Poles
 - b. North Dock Stock (low-value and high revolving parts commonly needed for jobs)

Reconciliation with SAP

3. Reconciliation with SAP for exceptions 1. b., c., d., and e. above is as follows:
 - a. Transformers are counted by Utilities staff once per month and results reconciled in their Access database. Total counts are reconciled with ASD Accounting staff annually.
 - b. Specialized and non-stock materials purchased for CIP projects are immediately charged to the relevant jobs, and do not pass through the inventory system.
 - c. IT consumables are expensed and delivered within 2 days to City Hall. These goods are not tracked in inventory system, but are counted and reconciled against the Purchase Order (PO).
 - d. IT servers, switches and WAPs above \$5,000 in cost are capitalized and any remainder is expensed. These goods are reconciled to PO and are not tracked in inventory system.
4. Reconciliation with SAP for items 2.a. and b. above is as follows:
 - a. Electric poles are physically counted by Utilities staff once per quarter and results reconciled with SAP.
 - b. For North Dock Stock, Utilities operates an open storage location for its crews. The location is kept locked between uses, and Utilities will submit to Stores quarterly physical inventories.

RELATED REFERENCE MANUALS AND PROCEDURES

- Purchasing Manual [CityConnect/Departments/Administrative Services/Purchasing Manual](#)
- SAP Training Manual [CityConnect/Departments/Administrative Services/Purchasing/SAP Training Manual](#)

Attachment E

Inventory Management PPP
Appendix 1

After Hours
Inventory Pull Sheet

Job Supervisor _____ Ext _____

Address of Job or Work Order Number _____

Date & Time _____ Items pulled by _____

Print Name

Stores Number	Item Description	Quantity Taken

Attachment E

Inventory Management PPP
Appendix 2



INVENTORY STOCK REQUEST

Additions / New

ITEM

Date: Requester:

Estimated Monthly Usage: Estimated Price: \$

Intended Application:

Materials & Engineering Standards No.: Attach QC controls? YES NO

Attach Special Handling Specifications or Requirements? YES

Age/Dating (Shelf Life) Min: Max:

If equipment or supply has parts will spares be needed? YES NO

If YES, please explain:

(Please complete additional requests for each part or attach list)

Does this replace Existing Stock? YES NO If YES, what Stock Item #:

Reason item needs to be stocked:

Other Divisions that may use product:

Product Description:

Suggested Brand: Model No.:

Packaging Spec: Units/package:

Suggested Vendor: Phone:

Address: City: State: Zip:

APPROVALS / REVIEWS / ROUTING (SIGNATURES)

Requested by:	Date: <input type="text"/>	Engineering:	Date: <input type="text"/>
	Name: <input type="text"/>		Name: <input type="text"/>
Dept/Div Approval:	Date: <input type="text"/>	Warehouse Review:	Date: <input type="text"/>
	Name: <input type="text"/>		Name: <input type="text"/>
Purchasing Approval (Buyer):	Date: <input type="text"/>	Final: Buyer's file at storage location.	Date: <input type="text"/>
	Name: <input type="text"/>		<input type="text"/>

Items will be available for distribution by:

STOCK NO.:

Attachment E

Inventory Management PPP
Appendix 3



CITY OF
**PALO
ALTO**

INVENTORY STOCK REQUEST

Deletions Revisions

ITEM

Date: Requester:

Estimated Monthly Usage:

Product Description:

DELETIONS AND REVISIONS TO EXISTING STOCK

Does this replace Existing Stock? YES NO Replacement Stock No.:

Other Divisions that may use product:

Stock No.:

- Eliminate Stock Item / Do not reorder
- Deplete Remaining Stock / Do not reorder
- Sell or Scrap Remaining Stock / Do not reorder
- Change in Safety Stock Level to:
 - Min Level:
 - Max Level:
- Change in Description

New Description:

Explanation for Revision / Deletion:

APPROVALS / REVIEWS / ROUTING (SIGNATURES)

Requested by:	Date: <input type="text"/>	Engineering:	Date: <input type="text"/>
	Name: <input type="text"/>		Name: <input type="text"/>
Dept/Div Approval:	Date: <input type="text"/>	Warehouse Review:	Date: <input type="text"/>
	Name: <input type="text"/>		Name: <input type="text"/>
Purchasing Approval (Buyer):	Date: <input type="text"/>	Final: Buyer's file at storage location.	Date: <input type="text"/>
	Name: <input type="text"/>		

Items will be available for distribution by:

STOCK NO. : _____

Attachment E

Inventory Management PPP
Appendix 4



SPECIAL INVENTORY STOCK ORDER
One-Time special order (no change to min/max)

ITEM

Date: Requester:

Part Number: Estimated Price: \$

Project Name:

Project Number: Order Number:

Quantity Needed: Date Order Needed:

Reason:

APPROVALS / REVIEWS / ROUTING (SIGNATURES)

Requested by:	Date: <input type="text"/>	Engineering:	Date: <input type="text"/>
	Name: <input type="text"/>		Name: <input type="text"/>
Dept/Div Approval:	Date: <input type="text"/>	Purchasing Approval (Buyer):	Date: <input type="text"/>
	Name: <input type="text"/>		<input type="text"/>

Items will be available for distribution by:

STOCK NO.:

Inventory “How-To’s” for User Departments

General Information

This is a brief informational sheet (helpful tips, approvals and updates) about managing parts in the warehouses’ inventory.

Helpful Tips

Before placing a part in inventory please consider that storing the spare part may not be economical or beneficial. Please ask yourself the following when considering adding a part to inventory.

Not Beneficial:

- » Parts might not be used, or may be used maybe once or twice a year
- » If a part is stored; the storing of the part may lead to defects
- » Maintaining inventory has costs associated with storing the part
- » Part is readily available when needed from a supplier

Beneficial:

- » Long lead time for parts
- » Part is needed in an urgent manner; no waiting for parts can be considered
- » Part is not readily available
- » Storing of the part will not cause any defects; long shelf life

Approval Process

All inventory requests are routed through Point of Contacts (POC), depending on the service group. When the Point of Contact (POC) receives the inventory request, this individual will approve or route accordingly to the appropriate approver within the department. Generally, the POC is the Operations Supervisor for that Utility. For the Water Quality Control Plant (WQCP), the Plant Manager is the POC.

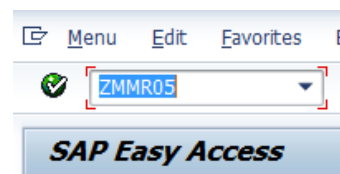
Inventory Updates

When a standard parts review or maintenance procedural update occurs, if parts are replaced by other parts, parts deleted, or parts added, min/max updates, etc.; this information and inventory paperwork needs to be submitted to the Inventory Manager. It is the responsibility of the Departments to inform Stores of what to have in inventory. The inventory listing is posted online via the City of Palo Alto’s website by the Inventory Manager.

SAP Report

If you choose to pull the report yourself, follow these steps.

From SAP, enter transaction code: ZMMR05



Attachment E

Enter in the Material Number range you're selecting. The below is an example pulling Water parts. The inventory department groups the Material Numbers depending on the type of part / inventory.

- 020000 – 029999 = Water
- 030000 – 039999 = Electric
- 040000 – 049999 = Gas
- 050000 – 059999 = Office Supplies
- 060000 – 069999 = Waste Water
- 090000 – 099999 = Safety / Public Works

Inventory Report

Selection Options

Material Number: 020000 to 029999

Storage Location: MSC to

Status: to

Sorting Options

Material Number

Storage Location

Output Format

List Viewer (ALV)

Standard Report

Storage Location: MSC or WQCP

Material	Description	Status	Lead Da...	U...	Avg. Price	Bin Location	GL for Consumption	In Stock	Order Pot...	Max Sto...	On Order	Back Order	FYTD Usage	Monthly Life Avg Use
020000	Box Valve Concrete 10.3/8" x 12" H round		14	EA	24.62	BIN GREEN	000032250	117,000	40,000	144,000	0,000	0,000	65,000	8,932
020001	Lid Valve Box, CI marked "Water"		21	EA	16.95	BIN RED	000032250	15,000	15,000	45,000	0,000	0,000	27,000	4,265
020002	Lid Valve Box, CI marked "Gas"		26	EA	16.96	BIN RED	000032250	19,000	15,000	40,000	0,000	0,000	21,000	3,712
020003	Lid Valve Box, CI marked "Manument"		28	EA	17.00	BIN RED	000032250	8,000	5,000	8,000	0,000	0,000	5,000	0,515
020004	Lid Valve Box, CI "Anode"		14	EA	18.37	BIN RED	000032250	25,000	15,000	25,000	0,000	0,000	8,000	1,311
020005	Extension Valve Box, ADS 10 ft.		28	EA	39.26	BIN RED	000032250	5,000	5,000	10,000	0,000	0,000	5,000	2,600
020020	Box Meter, Concrete B-9		21	EA	19.65	BIN GREEN	000032250	47,000	15,000	50,000	0,000	0,000	75,000	5,129

Once you've updated your report to show all the columns available, you will be able to use this information to assess your stored parts and materials.

Attachment E

Inventory Management PPP
Appendix 6

