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MICHAEL POST, C.P.A., M.B.A.
HARRIS COUNTY AUDITOR

July 16, 2021

MG Richard J. Noriega (Ret)
Interim Executive Director & Chief Information Officer
Harris County Universal Services

Dear MG Noriega:

Based on your request, Harris County Auditor's Office Audit Division has completed an audit of the Fleet Services' Parts Inventory. The results of our audit are included in the attached report.

We appreciate the time and attention provided by you and your staff during this engagement. Please anticipate an email request to complete the Audit Division's Post Engagement Survey. We look forward to your feedback. If you have any questions, please contact me or Errika Perkins, Chief Assistant County Auditor, 713-274-5673.

Sincerely,

Michael Post
County Auditor

Report Copies:
  District Judges
  County Judge Lina Hidalgo
  Commissioners:
    R. Jack Cagle
    Rodney Ellis
    Adrian Garcia
    Tom Ramsey
  Christian D. Menefee
  David Berry

FLEET SERVICES' PARTS INVENTORY

Executive Summary

OVERALL CONCLUSION

The controls related to Fleet Services' parts inventory have several opportunities for improvement. Processes that should ensure accuracy of annual inventory valuation, system access reasonableness, and general safeguarding of inventory items are not operating as management intended. Our review identified year-end inventory valuation errors; however, the extent of these errors could not be determined due to a lack of reconciliations from the County's financial system to Fleet Services' inventory management system, FleetWave. These areas for improvement are primarily driven by system limitations within FleetWave that have resulted in manual processes. Also, a lack of department policies and procedures regarding security access and segregation of duties have contributed to the current state of internal control limitations.

The issues were discussed with Major General Rick Noriega, Universal Services Executive Director, Josh Stuckey, Chief of Operations, James Henderson, Chief of Staff, John Dyess, Chief Administrative Officer, and Jim Smith, Fleet Operations Director. Based on this discussion, management action plans have been developed which will address the issues identified by September 30, 2021.

SCOPE AND OBJECTIVE

Audit Services conducted an audit to test controls of Fleet Services' parts inventory procedures. The objectives for this engagement were to:

1. Determine if annual inventory adjustments were accurately supported for fiscal year 2017 through 2021.
2. Evaluate current FleetWave system access for reasonableness based on job role.
3. Determine whether parts are properly safeguarded.

The audit reviewed current internal controls and inventory data from March 1, 2016 to February 28, 2021.

SUMMARY OF AUDIT ISSUES

1. Fiscal year 2017-2019 annual year-end inventory count valuations were not accurate.
2. A reconciliation between the County's financial system and FleetWave is not performed.
3. Controls over year-end physical inventory count need improvement.
4. Physical controls over safeguarding of parts need improvement.
5. Periodic reviews of system access in FleetWave are not consistently performed.
6. Controls over obsolete and used parts inventory need improvement.
7. Inadequate segregation of duties.
8. Inefficiencies in the receiving of parts.
9. Inefficiencies in the issuing of parts.

The audit issues, management's action plan to address the issues, and background information regarding this audit are discussed in detail on the following pages.

ISSUE #1: Fiscal years 2017-2019 annual year-end inventory count valuations were not accurate

What is the Issue: Year-end inventory balances were overstated for fiscal years 2017, 2018, and 2019.

Why it Happened: During the year-end inventory count for fiscal years 2017 through 2019, improper parts inventory valuation and calculation errors occurred. The valuation errors were caused by the improper assignment of parts unit cost from the transfer of Commissioner Precinct 3's fleet and maintenance. In addition, spreadsheet calculation errors occurred in fiscal year 2019. The valuation errors were not identified because there is no reconciliation between FleetWave and the County's financial system (see issue #2).

Why it Matters: Errors that were identified in fiscal year-end inventory count sheets caused inventory balances to be overstated by approximately $713K for fiscal year 2017, $529K for fiscal year 2018, and $180K for fiscal year 2019 on the County's financial statements.

What is Expected: The County Auditor's Accounting Procedure A.1-3, *Inventory Internal Control Guidelines,* requires transactions to be recorded accurately.

What Action(s) are Suggested: A complete and thorough review of fiscal year-end inventory count and valuation should be performed by a member of Fleet Services Management. This review should include an analysis of the before and after inventory count balances by location and on a consolidated Fleet Services basis. Fleet Services Management should establish inventory count and valuation variance thresholds.

Universal Service should consult with the County Auditor's Financial Accounting Division prior to any future transfer of fleet and maintenance parts between departments to ensure accuracy and completeness of the accounting.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

A review of FleetWave's capabilities, including inventory management is being done. As part of this assessment, Fleet Services is determining if upgrades to FleetWave, or an alternative system, is needed for a viable inventory management system. In the near term, training opportunities have been identified to assist with optimizing current capabilities of Fleet Wave.

Fleet Management, in conjunction with Universal Services leadership, will review and update its Fleet Services Inventory Management policy to be in line with, the County Auditor's Accounting Procedure A.1-3, *Inventory Internal Control Guidelines.* The policy will be updated and implemented before September 30, 2021 and will include the following:

- Inventory count and valuation variance thresholds based on best practices.
- A requirement to consult with the County Auditor's Financial Accounting department prior to any future transfer of fleet and maintenance parts between departments to ensure accuracy and completeness of the accounting.

- Before inventory counts are done, all transfers must be 100% completed from all locations; this will be done daily off parts inventory query.
- A parts inventory query will be made daily. The Parts Manager will look at the before and after transfer of parts to ensure the correct inventory for all locations.
- The Parts Manager will maintain a log recording transfers, noting the before and after locations of the part(s) and the employees involved in the part(s) transfer.
- All parts must be keyed in before inventory or tagged "DO NOT INVENTORY". No manual transfers will be made without approval of the Parts Manager.
- Daily inventory counts of five random parts.
- Monthly inventory counts of a random selection of 10% of the inventory.

Prior to September 30, 2021, the Auditor's Office is requested to supervise a Fleet Services parts inventory count by location. This complete and thorough review of fiscal year-end inventory count valuation will be performed by a member of Fleet Services Management, as well as by other non-Fleet Services personnel from Universal Services. This review will include an analysis of the before and after inventory count balances by location and on a consolidated Fleet Services basis.

Due Date: September 30, 2021

ISSUE #2: A reconciliation between the County's financial system and FleetWave is not performed

What is the Issue: A formal reconciliation of FleetWave parts inventory balances to the County's financial system inventory balances is not performed.

Why it Happened: A misunderstanding exists between Fleet Services Management and the County Auditor's Financial Accounting Division regarding the reconciliation procedures being performed during the monthly and year end closing processes. Each respective department was under the impression the other department was performing the reconciliation.

Why it Matters: FleetWave is not interfaced with the County's financial system. As such, an ongoing reconciliation between balances maintained in the County's financial system and equivalent balances from FleetWave will minimize the opportunity for errors, omissions, and significant adjustments to accounts.

Fiscal year 2021 had a $4.6 million year-end adjustment to the parts inventory balance recorded on the County's financial statements. This adjustment increased the parts inventory balance on the balance sheet. The increase was due to inventory purchases recorded in FleetWave and not recorded correctly in the County's Financial System.

What is Expected: Best Practices suggest that a reconciliation between primary and subsidiary systems should occur periodically.

What Action(s) are Suggested: Fleet Services Management should develop a formal reconciliation that, at a minimum, reconciles the respective FleetWave system balances to the equivalent County financial system balances for the following accounts and transactions on a monthly basis:

1. Part purchases
2. Accrual adjustments and related reversals
3. Total purchase balance
4. Total goods available balances
5. Obsolete inventory adjustments
6. Cost of goods sold balances
7. Ending inventory balances

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

A review of FleetWave's capabilities, including inventory management, is being done. As part of this assessment, Fleet Services is determining if upgrades to FleetWave, or an alternative system, is needed for a viable inventory management system. In the near term, training opportunities have been identified to assist with optimizing current capabilities of Fleet Wave.

The Fleet Services Inventory Management policy mentioned in the response to Issue #1 will include a procedure to reconcile the Fleet Services inventory balances with the County's financial system (PeopleSoft) at least once a month. This monthly reconciliation will include the following accounts and transactions:

1. Part purchases
2. Accrual adjustments and related reversals

3. Total purchase balance
4. Total goods available balances
5. Obsolete inventory adjustments
6. Cost of goods sold balances
7. Ending inventory balances

This reconciliation procedure will additionally:

- Establish stocking criteria to minimize over-stocking parts on hand.
- Require a monthly review of the inventory for all obsolete inventory and send these items to surplus.
- Ensure that the quantity of parts entered is accurate and all returns are adjusted properly.
- All quantities and purchase balance must be entered correctly based in invoice amount entered.
- Monitor the cost of goods and ending inventory balance by pre-counting parts on hand. This will be done daily to ensure accuracy.

Due Date: September 30, 2021

ISSUE #3: Controls over year-end physical inventory counts need improvement

What is the Issue: The inventory count sheets include expected on hand balances. In contrast, count sheets in a blind count would not include expected balances. In addition, the annual physical inventory count is not conducted by personnel independent of parts inventory.

Why it Happened: The parts manager is not removing the column labelled 'On Hand Quantity' prior to issuing inventory count sheets to personnel conducting year-end physical counts. In addition, Fleet Services Management does not require independent personnel to conduct the year-end inventory count process.

Why it Matters: Personnel conducting the physical year-end inventory counts are aware of the system inventory balances and can force physical count balances to match those system balances.

The purpose of the independent inventory counts is to mitigate any potential conflict of interest that exists between the Parts Manager and actual physical inventory count results.

What is Expected: Best Practices suggest that a blind count be performed in which the personnel conducting the year-end inventory count is not aware of the current on-hand inventory balances. Also, the County Auditor's Accounting Procedure A.1.3, *Inventory Internal Control Guidelines,* state that inventory counts should be coordinated by an employee who has no inventory responsibility.

What Action(s) are Suggested: The year-end inventory on-hand quantity should not be included on the count sheet, and the inventory count should be conducted by someone independent of the parts team.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

As noted previously, Fleet Services will update its Inventory Management policy to be in line with the County Auditor's Accounting Procedure A.1-3, *Inventory Internal Control Guidelines.* This policy update will detail procedures for the year-end inventory count, including that the on-hand quantities should not be included on the count sheet and that the inventory count will include Universal Services employees that are not a part of the Fleet Services team. In addition to the full annual inventory count, there will be daily spot checks by a person that did not inventory the parts during the annual count.

Due Date: September 30, 2021

ISSUE #4: Physical controls over safeguarding of parts need improvement

What is the Issue: Unsecured parts inventory is maintained in mechanic maintenance bays, unlocked cabinets in office area hallways, and in open overstock shelving located outside of parts designated areas. Doorways leading to designated parts areas are also left open.

Why it Happened: Fleet Services has not established guidelines for ensuring parts inventory are safeguarded.

Why it Matters: Allowing non-parts personnel to have access to parts inventory increases the risk of error and potential misappropriation. It can also interrupt the ability of Fleet Services to efficiently manage the sourcing and installation of parts onto County vehicles and equipment.

What is Expected: County Auditor's County-Wide Accounting Procedure A.1-3, *Inventory Internal Control Guidelines*, requires department management to ensure the safeguarding of inventory under the department's control. This safeguarding includes the use of physical barriers and access limitations.

What Action(s) are Suggested: Fleet Services Management should store parts inventory in a secured area with minimal contact by non-parts personnel.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

The parts inventory area at 2505 Texas is now secured and not open to unauthorized personnel. However, there is currently insufficient secured storage space to secure all parts, especially at the outlaying service centers where there is no specific parts manager. Additional funding is needed to hire additional parts managers and build secured parts storage areas to bring all service centers to the same standard as the 2502 Texas location. In the interim, to mitigate the insufficient secured storage space issue, the parts team will review stock on a monthly basis for any obsolete items that can be released to Surplus.

Fleet Services is also looking at an electronic workflow system that would include a scanning system to track parts as they are signed out of the inventory by mechanics. In the short-term, all parts will be keyed into a work order waiting for mechanic, and will be tagged to identify to where it belongs. Additionally, all parts will remain in a secured parts room, where applicable, while awaiting mechanic pick up to avoid unsecure parts in mechanic bays.

Due Date: September 30, 2021

ISSUE #5: Periodic reviews of system access in FleetWave is not consistently performed.

What is the Issue: A review of Fleetwave access identified 13 of 111 individuals that had the following user access issues:

- Four of the 13 active users could not be identified on the County's financial system Employee Master List.
- Nine of the 13 active users are terminated or retired County employees.

Also, changes to permission levels can be made by users who are not System Administrators.

Why it Happened: Fleet Services is not consistently performing periodic reviews of FleetWave system access, nor do they have documented and implemented system access policies and procedures. Also, FleetWave does not restrict modifications to permission levels to the System Administrators.

Why it Matters: Not performing a review of system access impairs the ability of Fleet Services to identify unauthorized access, which can lead to data breaches and potential segregation of duties issues due to incorrect role assignments.

What is Expected: Pursuant to the Universal Services Security Access Control Policy (County Security Access Policy) Section C.1.11, *Access Certification*, departments "must verify the membership, access and contents of the systems, applications and/or resources for which they have primary responsibility on a regular basis (at least once per year), to ensure that only authorized members maintain access to and permissions for the systems, applications and/or resources involved."

The County's Security Access Policy Section C.1.9, *User Termination*, states, "all user access privileges to Harris County systems and applications must be disabled immediately or, in any event, no later than 24 hours after an employee or non-employee termination."

What Action(s) are Suggested: Fleet Services should develop and implement internal policies and procedures for FleetWave system access that includes a periodic review (minimum annually) of user access and role-based assignments. In addition, Fleet Services Management should work with Universal Services to assess whether the FleetWave system can be upgraded to restrict system access changes to system administrators or if another system with this functionality may need to be explored.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

Fleet Services will develop and implement internal policies and procedures for FleetWave system access that includes an annual review of user access and role-based assignments. These internal policies and procedures will include which positions have system administrator access in Fleetwave and that FleetWave access will be revoked within 24 hours of an employee no longer being employed with Fleet Services. In addition, FleetWave will be assessed to determine if it can be upgraded to restrict system access changes to system administrators or if another system with this functionality may need to be explored.

Due Date: September 30, 2021

ISSUE #6: Controls over obsolete and used parts inventory need improvement

What is the Issue: Obsolete inventory that is removed from FleetWave is not recorded in the County's financial system, not consistently transferred to Purchasing Services for auction or disposal, and remains at Fleet Services shop locations.

In addition, used vehicle parts removed from inactive County vehicles and returned to Fleet Services for installation on active fleet vehicles are not tracked or recorded in FleetWave.

Why it Happened: The FleetWave system does not interface to the County's financial system. Additionally, Fleet Services does not have sufficient manual processes, including an obsolete/used parts policy, to compensate for the lack of an automated interface.

Why it Matters: Not recording obsolete inventory in the County's financial system and maintaining obsolete inventory at shop locations impacts the accuracy and completeness of inventory balances. Also, there is a missed opportunity for the department to recover funds from the potential sale of obsolete inventory.

Although used parts inventory should be valued at zero cost on inventory records, it is important to record the item as inventory to demonstrate transactional completeness and general stewardship of County property.

What is Expected: County Procedures Manual I.6, *Furniture and Equipment Surplus Property,* states that "During the course of each year, property may be replaced, break, becomes obsolete or unnecessary, or be otherwise deemed unusable by the Department. Regardless of the initial cost of an item, if the Department determines that an item is surplus, the item is to be transferred to Purchasing, another Department, or another section within the Department in accordance with this procedure and the Harris County Purchasing Agent Rules and Procedures."

In addition, County Auditor's County-Wide Accounting Procedure A.1-3, *Inventory Internal Control Guidelines,* requires department management to clearly document all transactions.

What Action(s) are Suggested: Fleet Management should perform periodic reviews of obsolete inventory and inform Financial Accounting of all obsolete balances that have been removed from FleetWave. Fleet Management should also coordinate with Purchasing Services to transfer the obsolete inventory to Purchasing Service's warehouse for proper disposal.

In addition, Fleet Management should record used parts inventory in FleetWave with a zero cost value.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

As mentioned in the response to Issue #4, the parts team will review stock on a monthly basis for any obsolete inventory that can be released to Purchasing for proper disposal. Additionally, the Parts Manager will inform Financial Accounting of all obsolete balances that have been removed from FleetWave and record used parts inventory in FleetWave with a zero cost value. A parts number will be created in FleetWave for used parts at zero cost to keep control of them and to track parts movement at all times.

Due Date: September 30, 2021

ISSUE #7: Inadequate segregation of duties

What is the Issue: Responsibilities within the parts purchasing and receiving process are not properly segregated. Specifically, the following was noted:

- Placing orders for parts from vendors via phone or website.
- Physically picking up or receiving delivered parts.
- Recording delivered parts into FleetWave.
- Recording transfers in and out of FleetWave.

In addition, certain FleetWave permission levels allow an individual user to perform both transferring of parts out of one location's inventory and receiving the parts into another location's inventory.

Why it Happened: Fleet Services currently does not have processes or policies that address segregation of duties. In addition, FleetWave user permissions are not appropriately defined or understood for a user's job role.

Why it Matters: Inadequate segregation of duties and the lack of proper system access may result in misappropriation of assets and financial loss to the County.

What is Expected: County Auditor's County-Wide Accounting Procedure A.1-3, *Inventory Internal Control Guidelines,* requires department management to segregate key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud including separation of the responsibilities for authorizing, processing, recording, and reviewing transactions, as well as handling any related assets.

What Action(s) are Suggested: Fleet Services Management should develop and implement written internal policies and procedures addressing segregation of duties over parts inventory. If duties cannot be separated due to resource constraints, appropriate monitoring by management should occur to minimize the risk of misappropriated assets.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

The Fleet Services Inventory Management Policy will be updated and include procedures to address segregation of duties over parts inventory. The updated policy will also include the following provisions:

- Ordered parts will have an equipment number on the invoice to track to who it belongs to and will be put into FleetWave for historical tracking.
- Stock orders will only be placed by a designated Parts employee, with a list so that all Parts team members know what is being ordered.
- Parts that are called in for pick up will be picked up by someone other than the person that put in the call; this allows for additional review of the invoice of parts checked in and stocked in.
- All invoices will have a signature and printed name of the person processing the invoice.

Due Date: September 30, 2021

ISSUE #8: Inefficiencies in the receiving of parts

What is the Issue: Parts personnel are not receiving delivered parts timely into FleetWave inventory due to a system limitation.

Why it Happened: Parts personnel circumvent the FleetWave receiving process due to FleetWave's inability to record and retain the unit cost on an open FleetWave purchase order. For example, if a subsequent FleetWave purchase order is created for the same part but at a different unit cost, any previous open FleetWave purchase orders will be updated with the most recent unit cost entered for that particular part. Therefore, parts personnel delay creating a FleetWave purchase order and receiving parts into FleetWave until the invoice is received.

Why it Matters: Waiting for the supplier invoice before entering inventory purchases into FleetWave causes a temporary understatement of inventory amounts in the system. This can create inefficiencies in inventory management as parts personnel will not be aware of actual part counts available to them.

What is Expected: County Auditor's County-Wide Accounting Procedure A.1-3, *Inventory Internal Control Guidelines,* requires department management to record transactions timely, completely, and accurately.

What Action(s) are Suggested: Fleet Services Management should work with Universal Services to assess whether the FleetWave system can meet the current needs of the County or if other more effective/efficient systems exist. In the interim, management should implement processes to periodically confirm inventory received and should monitor inventory levels.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

Universal Services is working with FleetWave developers to determine why the unit cost is overridden and to determine if the issue can be corrected. This issue is one of several factors in determining if upgrades to FleetWave, or an alternative system, is needed for a viable inventory management system. In the meantime, Fleet Services will implement processes to periodically confirm inventory received and should monitor inventory levels. This includes, but is not limited to:

- Work with vendors to get invoices as soon as possible at the same time as parts received.
- All parts will be checked for accuracy and then keyed into Fleet wave ASAP, no more than 24 hours after receipt.
- Using a numbering system that reflects the cost to the item being billed at that time to eliminate cost overage.

Due Date: September 30, 2021

ISSUE #9: Inefficiencies in the issuing of parts

What is the Issue: The issuing of parts by parts personnel is done through a series of hardcopy paper requests that cycle through a manual workflow.

Why it Happened: FleetWave does not have an internal workflow to communicate a mechanic's parts requests to the parts personnel fulfilling those requests. As a result, manual order sheets are completed and manually routed for ordering.

Why it Matters: The manual nature of inventory parts fulfillment creates inefficiencies by requiring excessive data entry and opens up the process to greater risks of inventory errors.

What is Expected: County Auditor's County-Wide Accounting Procedure A.1-3, *Inventory Internal Control Guidelines,* requires department management to record transactions timely, completely, and accurately.

What Action(s) are Suggested: Fleet Services Management should work with Universal Services to assess whether the FleetWave system can meet the current needs of the County or if other more effective/efficient systems exist. In the interim, management should implement processes to periodically monitor inventory levels.

MANAGEMENT'S ACTION PLAN

Responsible Party: Universal Services Chief Operating Officer

FleetWave is currently being reviewed to determine if it can meet the current needs of the County, including a digital workflow system to replace the current paper-based work order system. As part of this assessment, Fleet Services is determining if upgrades to FleetWave, or an alternative system, is needed for a viable inventory management system. While this assessment is being done, Fleet Services will implement processes to monitor inventory levels. This includes, but is not limited to the following:

- Daily and monthly inventory checks, as discussed under Issue #1.
- Parts will be double checked as it is entered into the system, with invoice signed off by parts counter employee.

Due Date: September 30, 2021

BACKGROUND

Harris County Fleet Services offers vehicle and equipment management services to Harris County departments. Services provided include new vehicle procurement, managing fuel stations, and routine vehicle maintenance. The services are currently conducted at eight locations around the County and employ 32 mechanics along with 15 service supporting staff.

The Fleet Services team currently supports 6,649 County employees from 42 different agencies. Fleet-related services are provided for over 3,600 County vehicles and 1,000 other County owned equipment.

ACCOUNTABILITY

The work performed required our staff to exercise professional judgment in completing the engagement's scope. As the engagement's scope did not include a detailed examination of all transactions, there is a risk that fraud, errors, or omissions were not detected during this engagement. The official, therefore, retains the responsibility for the accuracy and completeness of their financial records and for ensuring sufficient controls are in place to detect and prevent fraud, errors, or omissions.