



CITY AUDITOR'S OFFICE

Warehouse Operations

October 31, 2019

AUDIT REPORT NO. 2010

CITY COUNCIL

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October 31, 2019

Honorable Mayor and Members of the City Council:

Enclosed is the audit report for *Warehouse Operations*, which was included on the Council-approved FY 2019/20 Audit Plan. This audit was conducted to evaluate management controls over and cost-effectiveness of the City's warehouse operations.

The audit found that Warehouse management has not established appropriate controls to manage its Stores operation. As well, surplus property policies and procedures are not consistently followed, and practices could be improved. Further, the Warehouse could more efficiently promote internal surplus property transfers as prioritized in City Code, and storage and shipping functions need to be clarified or strengthened.

If you need additional information or have any questions, please contact me at (480) 312-7867.

Sincerely,

A handwritten signature in blue ink that reads "Sharron Walker".

Sharron E. Walker, CPA, CFE, CLEA
City Auditor

Audit Team:

Lai Cluff, CIA – Senior Auditor
Brad Hubert, CIA, CGAP – Senior Auditor

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AUDIT HIGHLIGHTS

Warehouse Operations

October 31, 2019

Audit Report No. 2010

WHY WE DID THIS AUDIT

The *Warehouse Operations* audit was performed to evaluate management controls over and cost-effectiveness of the City's warehouse operations. The audit was included as part of the City Council-approved audit plan for fiscal year (FY) 2019/20.

BACKGROUND

The City's Purchasing Department operates a warehouse function that receives, delivers and stores items for City departments; operates a supply store to provide commonly used maintenance and repair supplies to departments; posts public auctions to sell surplus City property along with Police Property & Evidence items that cannot be returned to their owners; and disposes of items that cannot be sold. The Warehouse also handles some shipping requests and certain surplus materials recycling.

The Warehouse, located at the North Corporation Yard, operates on weekdays from 6:00 a.m. to 2:30 p.m. and is staffed by a manager, 2 senior stock clerks and 2 technicians.

City Auditor's Office

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WHAT WE FOUND

Management has not established appropriate controls to manage its Stores operation.

- Issuances are not entered as they occur, receipts are not provided, and refunds are not adequately documented.
- Inventory counts, adjustments and corrections are not properly conducted and documented, and inventory item units do not always align with issuance units.

Surplus property policies and procedures are not consistently followed, and practices could be improved.

- The items reviewed for appraisal are not documented.
- Disposition of some items could not be verified, tax exemptions were not documented, the refund policy was not followed, and some disposals have been informally delegated to other departments.
- Adjusting certain practices may increase auction revenues.

The Warehouse could more efficiently promote internal surplus property transfers as prioritized in City Code.

- Available surplus property is not communicated to City departments.

Other Warehouse functions and responsibilities need to be clarified or strengthened.

- Stored items are not consistently tracked, and shipping may be more effectively managed by individual departments.

WHAT WE RECOMMEND

We recommend the Purchasing Director ensure the Warehouse Manager:

- Requires staff to enter issuances as they occur and provide receipts, adopt inventory count policies and procedures, document stock adjustments and establish inventory units consistent with issuance units.
- Implements appropriate segregation of duties, verifies surplus items as they are received, and follows tax and refund policies.
- Notifies other departments of available surplus, tracks stored items and discontinues routine shipping for other departments.

MANAGEMENT RESPONSE

The department agreed with the audit recommendations, noting that other affected departments will be consulted during its process of improving controls.

BACKGROUND

This audit of *Warehouse Operations* evaluates management controls over and cost-effectiveness of the City's Warehouse operations. The City Warehouse is located at the North Corporation Yard and managed by the Purchasing department.

The Warehouse, staffed by a manager, 2 senior stock clerks, and 2 technicians, operates Monday through Friday, from 6:00 a.m. to 2:30 p.m. Primary functions include receiving and delivering goods purchased by departments, operating a supply store, and disposing of surplus property. As well, the Warehouse handles shipping requests and certain materials recycling, such as metals, water meters and wires.

Receiving

Purchases by City employees and the Purchasing department may be delivered directly to the departmental worksite or to the Warehouse. For items purchased on an itemized purchase order and delivered to the Warehouse, the Warehouse staff verify the shipment quantities and enter the receiving information into the SmartStream accounting system. For items purchased on a blanket purchase order or a procurement card where the ordered quantities are not available to be confirmed, the Warehouse staff contacts the employee or department on the package to ask for delivery instructions. These items may be delivered to the purchaser or held at the Warehouse for pick up.

In Fiscal Year (FY) 2018/19, Warehouse staff received about a third of commodities items purchased through City purchase orders. Most procurement card purchases are delivered directly to the purchasers. Items received by the Warehouse are generally delivered to the purchaser's office, but the Warehouse does not deliver to the northern area fire stations or certain Water facilities.

Stores

The Warehouse purchases and stocks an inventory of commonly used maintenance and repair supplies for various City departments. As shown in Table 1, at June 30, 2018 and 2019, the year-end Stores inventory balance varied between \$250,000 and \$165,000.

Table 1. Stores Inventory Account Balances, FY 2017/18 and FY 2018/19

	FY 2017/18	FY 2018/19
Beginning Balance	\$ 255,642	\$ 250,079
Supplies - Direct Issue	(681,478)	(681,305)
Supplies - Inventory Adjustment	22	(334)
Supplies - Issue on Requisition	(4,083)	(3,871)
Supplies - Receive Return	1,853	6,068
Purchases	677,381	594,415
Request for Adjustments	742	0
Ending Balance	\$ 250,079	\$165,052

SOURCE: Auditor analysis of SmartStream reports of Stores inventory account transactions.

Examples of commonly used supply items are summarized in Table 2, with the top ten items ranked by cost and by quantity.

Table 2. Top 10 Stores Items Issued by Total Cost and by Quantities, FY 2018/19

Rank	By Total Cost	Cost	Rank	By Quantity Issued	Qty
1.	Can Liners 36"x 58", 50/CS	\$54,700	1.	Gasket 1" Blk Rubber 1/16"	8,380
2.	1x60K Rolled Copper	\$38,600	2.	Gasket 3/4" Blk Rubber 1/16"	7,420
3.	Mutt Mitts 6000 Bags/CS	\$33,500	3.	Gasket 1" Rubber	7,300
4.	3/4x60K Rolled Copper	\$24,000	4.	Gasket 3/4" Rubber	6,640
5.	Meters Bx #1 Body/Cover	\$18,400	5.	Battery AA, ea.	4,592
6.	28" Safety Cone	\$14,500	6.	G-tek Gloves, Large	2,948
7.	Meter Stop 1" Copper	\$13,600	7.	G-tek Gloves, Xlarge	2,583
8.	Flares, 20 Min, No Spike	\$12,800	8.	Battery AAA, ea.	2,567
9.	G-tek Gloves, Large	\$10,800	9.	Can Liners 36"x 58", 50/CS	2,124
10.	Hymax 6" Pipe Coupling	\$10,700	10.	32W F32T8 Fluorescent Tube	2,050

SOURCE: Auditor analysis of SmartStream reports of Stores transactions. Costs estimated based on July average unit costs.

In FY 2018/19, the Warehouse recorded approximately 10,600 Stores issuances, with almost 99% being walk-in transactions. These transactions, also called Direct Issue, occur when a City employee comes to the Warehouse to select the items needed rather than a department sending an electronic requisition in advance. A Warehouse employee assists walk-in requesters by writing up the items issued along with the requester's department code so that the department's budget is charged for the items.¹ Otherwise, departments enter electronic requisitions through the SmartStream accounting system and items are charged to the requesting department's budget when Warehouse staff print the requisition to pull the items. These orders are delivered to the requester.

Generally, Stores items are purchased from pre-approved vendor contracts, and stock items are reordered automatically each week when on-hand amounts fall below pre-established quantities. The Sr. Stock Clerk reviews these system replenishment orders and obtains current pricing information for items, such as copper piping, with fluctuating market prices.

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¹ A Stores item's cost is recalculated with each purchase of additional stock. A weighted average cost, using the weighted average cost of the quantities on-hand and the cost of new quantities added, is then used to value the inventory item.

In FY 2018/19, the Stores recorded about \$685,000 in supplies issued to various City departments. As shown in Figure 1, the Water division is the Stores largest customer, receiving about 58% of annual issuances.

According to Water representatives, some of the division's departments also rely on Stores supplies to make emergency repairs. To allow after-hours access, the Warehouse created a caged area containing certain Water supplies that is accessible to authorized Water staff. These items are charged to the department's budget when placed in the caged area and then regularly replenished by the Warehouse staff as they are used.

Surplus Property

Scottsdale Revised Code establishes that the Purchasing director is responsible for selling, trading or otherwise disposing of surplus personal property belonging to the City. Other departments are not authorized to transfer, sell, trade, loan, give away or otherwise dispose of property owned by the City.² The Purchasing director has assigned the Warehouse to manage surplus property responsibilities. Surplus items are generally disposed through a contracted online auction service.

Generally, the Warehouse receives two types of surplus property:

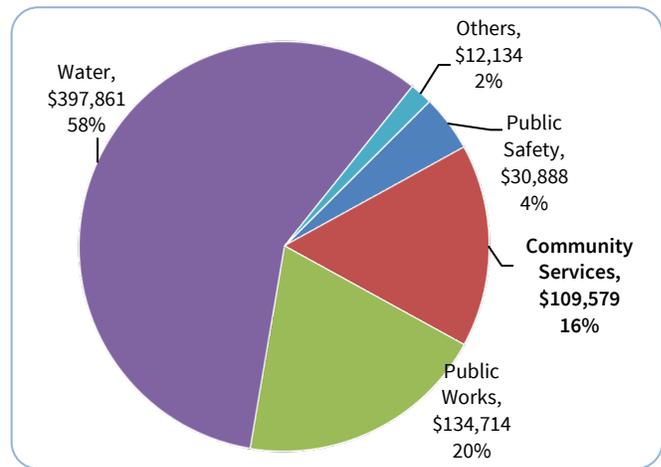
- 1) City surplus property, which are departmental items no longer needed or past its useful life, and
- 2) Property & Evidence surplus, which are unclaimed evidence and found items declared by the Police department as available for disposition.

City Surplus Property

While some property and equipment items are replaced on a cyclical basis, such as vehicles and technology, other items are replaced based on usability or other needs. Typical City surplus items sent to the Warehouse for disposition have included:

- *Fleet vehicles and equipment* – When sending City vehicles and related equipment to the Warehouse for disposition, the Fleet Management department provides, as applicable, the vehicle title, keys, and a specification sheet. Vehicle replacements vary based on mileage and usage.
- *Information Technology equipment* – The Information Technology department manages the City's inventory of computers, mobile devices, servers, peripherals and other technology equipment. Computers and other devices, which are generally replaced on a 5-year cycle, are wiped of City data prior to sending them for surplus auction. Surplus technology equipment is delivered to the Warehouse weekly.

Figure 1. FY 2018/19 Stores Inventory Issued, by Division



SOURCE: Auditor analysis of SmartStream reports of Supplies issuance transactions.

² Scottsdale Revised Code § 2-206.

- *Miscellaneous City items* – Other City departments periodically have surplus furniture, equipment, or supplies that are also sent to the Warehouse for disposition.

Property & Evidence Surplus

When items held by the Police department as evidence for criminal investigations or cases are no longer needed, they are released back to the owners. If, after the required notifications and time have elapsed, an item has not been claimed by its owner, it becomes City surplus property and is transferred to the Warehouse for auction. ³ These transfers may also include unclaimed lost or found items that the department has not been able to return to rightful owners. Property & Evidence items have often included:

- *Jewelry and watches* - Since late 2015, the Warehouse has contracted with a professional jewelry appraiser to review these items and provide a written appraisal of the higher-value jewelry and watches transferred from Property & Evidence.
- *Firearms and ammunition* – These items are not sold through the online surplus property auction. Instead, the Purchasing department issues a solicitation for an Offer to Purchase from licensed firearms dealers.
- *Bicycles* – These items may include lost or stolen bicycles.
- *Miscellaneous* – A wide range of other items, such as electronics, tools, and clothing, have been transferred for disposition.

Surplus Auctions

The Warehouse acquires auction services through PublicSurplus.com, an online-only auction platform that is used by government agencies across the country. The web application allows users to customize their auction pages and set terms for their auction sales, such as reserve prices, pick-up times and locations, and payment requirements. In FY 2018/19, Warehouse staff posted about 850 auctions, averaging about 3.4 auctions per workday. Warehouse staff create auctions with photographs and product descriptions and uploaded them to the website. While auctions are typically open for 7 days, heavy equipment and some vehicle auctions, such as fire trucks, are left open for up to 21 days to encourage more bids.

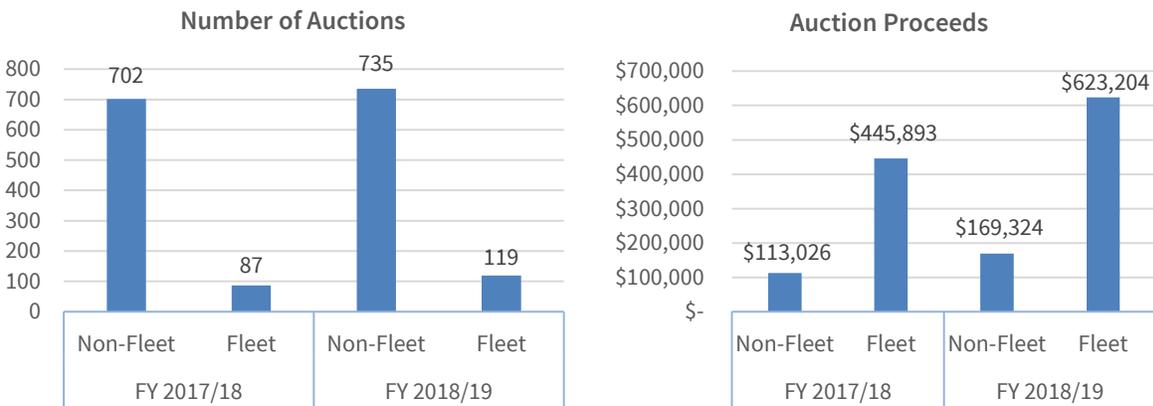
The winning bidder makes the auction payment online through Public Surplus, and must pick up the purchased item(s) at the Warehouse during the specified pick-up times of Tuesdays, Wednesdays, and Thursdays between 9 a.m. and 1:30 p.m.

As shown in Figure 2 on page 7, the FY 2018/19 auctions of Fleet equipment and vehicles comprise 79% of auction proceeds, while representing only about 14% of the auctions.

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³ According to the Police department's Property & Evidence staff, written notification is sent to the last known owner. As well, the department posts a listing of lost, unclaimed or found items on the City website.

Figure 2. Surplus Property Auction Counts and Proceeds



SOURCE: Auditor analysis of PublicSurplus.com Sold and Paid report.

Public Surplus charges a 7% auction fee and a 3% payment processing fee which the buyer pays in addition to the winning bid. Public Surplus retains the fees and remits the bid amounts to the City. While Fleet vehicle auction proceeds are deposited into the Fleet internal service fund, all other surplus auction proceeds are deposited into the City's General Fund.

OBJECTIVES, SCOPE, AND METHODOLOGY

An audit of *Warehouse Operations* was included on the City Council-approved fiscal year (FY) 2019/20 Audit Plan. The audit objective was to evaluate management controls over and cost-effectiveness of the City's warehouse operations.

To gain familiarity with Warehouse operations, we reviewed previous audits and findings issued by this office including Audit 1513.01 *Controls Over Surplus Property Disposition* and related follow-up work. We also reviewed a finding related to Warehouse operations from Audit 1111, *Meter Reading*. We also reviewed warehouse and inventory management audits recently performed by other government auditors.

To identify regulations related to surplus property, we reviewed *City Procurement Code* Sections 2-206-210 relating to the listing, disposition and proceeds of surplus personal property. For inventory requirements and best practices, we reviewed City Administrative Regulation (AR) 226 – *Capital Assets* and AR 227 – *Non-Capital Assets*, along with *GAO Best Practices in Achieving Consistent, Accurate Physical Counts of Inventory and Related Property* published March 2002. As well, AR 268 – *Cash Handling* was reviewed for requirements related to financial transactions.

To gain an understanding of the Warehouse processes, we toured the warehouse and interviewed the Warehouse Manager, the two Senior Stock Clerks and the two Warehouse Technicians. Auditors also observed a transfer of Property & Evidence surplus to the Warehouse and a jewelry appraisal conducted by an independent appraiser. Additionally, we interviewed staff from other City departments that use the Warehouse, including representatives from the Fire Department, Police Property & Evidence, Capital Project Management, Street Operations, and Water Resources.

To evaluate whether Warehouse controls and procedures are adequate to safeguard and accomplish City objectives regarding surplus property, we:

- Selected a judgmental sample of jewelry and other items transferred from Police Property & Evidence transfer records and reviewed the supporting documentation for the transfer, appraisal (if performed), and auction information.
- Reviewed the supporting documentation for 10 judgmentally selected Fleet auctions.
- Obtained technology surplus transfer documents from the IT department and traced the items to the auction records to determine if all items were accounted for.
- Identified and selected a judgmental sample of internal City surplus items and reviewed auction and disposition records.
- Reviewed user access and the contract terms and conditions through the online auction services provider.
- Reviewed supporting documentation for 4 of 18 auction refunds and requested documentation for tax-exempt transactions.

To determine whether existing processes for Stores operations are effective, we:

- Evaluated controls over processes for supplies issuance, returns, inventory counts, and inventory adjustments. Procedures included review of documentation for issuances, returns, inventory counts, and user access to system functions.
- Calculated the inventory turnover and reviewed the turnover reports used by the Warehouse.

To determine the effectiveness of other warehouse functions, we:

- Interviewed departments storing property at the Warehouse to determine if records are maintained and periodic inventories are performed.
- Reviewed supporting documentation for Warehouse shipping transactions.

Our audit found that management has not established appropriate controls to manage its Stores operations, surplus property policies and procedures are not consistently followed, and internal surplus property transfers can more efficiently promoted and prioritized. Other warehouse functions, such as warehousing of goods and shipping, need to be clarified or strengthened.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Audit work took place from July to October 2019.

FINDINGS AND ANALYSIS

1. Management has not established appropriate controls to manage its Stores operation.

The warehouse Stores stocks supplies to issue to various City departments as needed for emergency repairs, construction projects, or routine maintenance. The Warehouse purchases selected supplies, which are held as inventory until items are issued and charged to the user department's budget.

However, current processes do not provide adequate accountability for the items that are stocked and issued.

A. Stores operation lacks segregation of duties to reduce the risk of fraud and errors.

One employee is responsible for nearly all functions related to the Stores operation, with limited supervisory involvement. While other Warehouse staff also issue supplies and manually fill out the requisition forms, one employee enters all transactions into SmartStream, replenishes inventory, updates stock and catalog information, periodically performs inventory counts and adjustments, and processes any returns.

Warehouse staff assisting Stores customers fill out a requisition form to document the items issued. Later, a Sr. Stock Clerk enters these hand-written requisition forms into the SmartStream system. Having each authorized staff enter transactions as they occur would allow the staff to verify that the correct item number was entered by checking the item description and to issue a system-generated receipt for the transaction. Direct transaction entries would also enable the system to accurately capture the time of and the employee responsible for the transaction. Currently, system reports indicate that one employee performed nearly all transactions. To more accurately reflect performance, the Warehouse Manager requires his employees to manually track how many Stores customers they assist.

Appropriately separating key responsibilities relating to custody of assets, recordkeeping, reconciliation, and authorization helps reduce the risk of fraud and errors. In this situation, it would also result in more efficient recordkeeping.

B. The inadequate separation of duties is further exacerbated by the practice of not providing receipts to confirm items issued and not documenting returns/refunds.

1. Nearly 99% of Stores transactions are issued to walk-in customers, meaning a requisition was not submitted in advance. Although Warehouse staff fills out a handwritten Stores requisition form for the issued items, the customer does not receive a copy. Not providing a receipt at the time of the transaction increases the risk of mistakes in the items or entered quantities and later alterations of the recorded information.

When asked how departments would know what items are being provided, Warehouse staff commented that departments receive monthly reports of their Stores purchases. The Water

Top 5 Stores Items Issued

- Can Liners, 50/cs
- 1 x 60K Rolled Copper
- Mutt Mitts, 6000 bags/cs
- ¾ x 60K Rolled Copper
- Meter Box #1 Body/Cover

SOURCE: SmartStream reports, based on total cost of items issued.

division, the largest user of the Stores supplies, runs a monthly report of walk-in sales by cost center and sends it to supervisors to review. Other departments that we interviewed were not aware of this report and instead relied on the “Direct Issue Supplies” charges to their budgets for an indication of supply use. However, these charges do not describe the specific items or quantities used. Further, a monthly supervisory review of the walk-in sales report may not detect errors that can occur or inappropriate supply usage. Instead, if the Warehouse staff provided the employee receiving the supplies a requisition copy, the employee can confirm the items and quantities received and that detailed copy could be used in the departmental supervisory reviews.

2. Returns are not adequately documented. The Sr. Stock Clerk who manages the Stores operation recordkeeping and has access to the inventory items also processes any returns. Refund documentation, including who requested the return and the reason for the return, is not maintained. Further, the Warehouse Manager does not sign off on any returns although, according to the Sr. Stock Clerk, some of the return transaction requests originate from the manager.

Though no cash is exchanging hands during a Stores transaction, assets are being transferred and expenses charged to other department budgets. City Administrative Regulation (AR) 268, *Cash Handling*, requires that all transactions be immediately accounted for using the location’s automated system and all customers must be provided a receipt validating the transaction with quantity, description of purchase, amount and form of payment. As well, this AR requires the reason for refunds to be documented with the request dated and signed by the patron requesting the refund and the approving supervisor.

C. Inventory counts and related adjustments are not appropriately conducted.

1. An annual inventory count is conducted at the end of the fiscal year. While the inventory procedures state that a “blind” count should be performed, this method was not used for the June 2019 counts. The Warehouse Manager stated that he was aware blind counts were an option, but the Warehouse staff conducting the counts were given inventory sheets listing the expected counts. Blind counts are recommended as best practice because this method prevents counters from being influenced by the quantities that should be on hand according to the inventory records.

“Blind” inventory counts use inventory listings that do not display the inventory record’s quantity on hand. Instead, the counter records the number of physical items in stock for later comparison to the inventory records.

Additionally, the Warehouse Manager stated that when the counters identified variances, he and the Sr. Stock Clerk in charge of the Stores recounted the items and corrected them after erasing the original counts. This process alters the documentation without keeping a record of who changed the original count and what the change was.

Any remaining uncorrected variances are then given to the Purchasing department’s system integrator to enter as inventory adjustments.

2. The Sr. Stock Clerk also performs “cycle” counts 4 to 5 times a year, including one just a couple weeks prior to the year-end inventory count. These cycle counts, performed as blind counts using a vendor-based listing of stock items, may be completed over the course of a

couple weeks as time permits. After performing the counts, the Sr. Stock Clerk verifies the on-hand quantities in the system and marks all variances. The Sr. Stock Clerk explained that variances are usually caused by errors in noting the item number or quantities issued, and he may spend hours searching to find and correct the errors. He then corrects the variances by issuing additional quantities to the departments that use the items or by moving excess inventory items to a top shelf as “overflow.”

Documentation of the cycle counts and related adjustments is typically not retained. Further, since corrections are entered as issuance transactions rather than adjustments, the past changes to items and quantities cannot be determined.

Although not typically retained, documentation was still available for the most recent cycle count conducted two weeks prior to the year-end inventory. This documentation revealed that, of approximately 8,000 items counted:

- 625 shortages totaling about \$5,000 were subsequently charged to user department budgets, and
- 85 overages totaling about \$1,500 were apparently moved to the top shelf and not counted during the year-end inventory.

These variances differ significantly from the 70 total items reported as variances for the year-end inventory. Further, many of the reported year-end variances occurred in items that were not adjusted during the June cycle count two weeks earlier.

According to the Warehouse Manager, while he is aware that periodic cycle counts are performed regularly, he is not involved with them, and he does not require staff to keep a record of the counts or submit any related adjustments for approval. There are no written policies or procedures to guide staff on how to properly conduct and document periodic inventory counts and make related adjustments.

- D. The item units used in the inventory system sometimes do not match the standard issuance units. For example, AA batteries are purchased in a 24-count case packaged in 4-pack units, but the inventory system quantities and pricing are based on a per-battery unit cost. As well, the item description states that it is a “24-pack” even though the unit of measurement is “each.”

These discrepancies make it more difficult for Warehouse staff to efficiently record accurate issuances. While the Sr. Stock Clerk is aware that inventory unit differences contribute to the volume of recordkeeping errors, he indicated it would be time-consuming to correct them. Given the tedious nature of searching for possible discrepancy causes and correcting inventory records on an ongoing basis, modifying the inventory system units to match typical issuance units could reduce recordkeeping errors and improve efficiency.

Figure 3. Example of Inventory Units



SOURCE: Auditor analysis of inventory records.

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Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Requires staff handling the inventory transactions to input them directly into SmartStream as they occur to increase accountability and efficiency.
- B. Requires staff to issue receipts to assist departments in reviewing supply usage and appropriately document returns and refunds with transaction and requester details for manager approval.
- C. Adopts policies and procedures to ensure that inventory counts are conducted and documented properly, including documentation of inventory adjustments and management approval.
- D. Requires staff to modify the inventory system information so that the item units match the units that are typically issued.

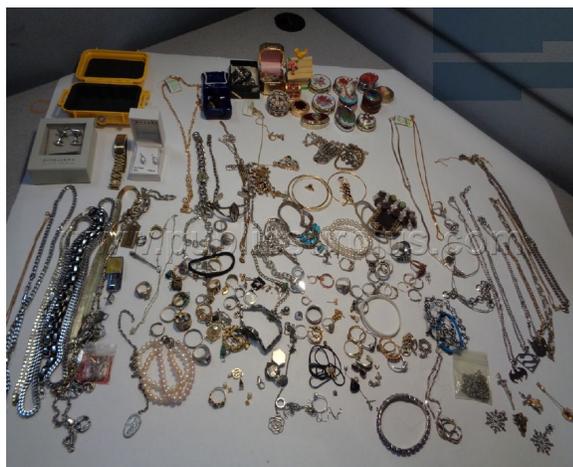
2. Surplus property policies and procedures are not consistently followed, and practices could be improved.

Controls over the auction of surplus items have improved, but additional segregation of duties is needed to safeguard assets. The Police department's Property & Evidence surplus items result from the department not being able to locate the rightful owners of items that were related to a completed crime investigation or found items received by the department. The department then transfers these items to the Warehouse for disposal by auction. Other City departments also transfer items that are no longer considered necessary, such as the Information Technology department sending outdated computers and other technology items.

- A. Inconsistencies between surplus property documentation and items uploaded for auction should be investigated and resolved, and additional segregation of duties can improve safeguarding of assets.
 1. Since a City Auditor review of Surplus Property in 2015, the Warehouse has implemented several recommended processes, including keeping the Property & Evidence jewelry in a safe, obtaining an appraisal to identify higher value items, and documenting the destruction of items determined to be counterfeit. However, certain controls need further improvement.
 - Warehouse staff does not maintain documentation of all jewelry items provided to the contracted professional appraiser for review. While written procedures indicate Warehouse staff judgmentally separates out higher value items for appraisal, Warehouse staff indicated all available jewelry is given to the appraiser for his determination of which items merit a full appraisal. Having the appraiser sign a list of all items reviewed would better document the process being followed.

- When we tried to trace a sample of 21 jewelry items from the Property & Evidence transfer documents to the related auctions, unless an item received an individual appraisal, it is still often difficult to verify whether the described item was auctioned. Many of the jewelry items are auctioned in a bundled lot of miscellaneous jewelry. For example, an item described on the Property & Evidence transfer documents as “Wedding Rings” was recorded as being auctioned in a combined lot labeled “Lot of Misc. Jewelry.” See Figure 4 for an example auction photo of a combined jewelry lot.
- Controls could be further strengthened by adding an independent asset custodian. Currently, the surplus items are picked up from the Police Property & Evidence staff by two Warehouse staff: the Warehouse Manager and a Sr. Stock Clerk. These Warehouse staff each have access to the safe where the items are stored, provide items to the jeweler for appraisal and have full access controls to the auction website. Further, significant time elapses between the items being transferred to the Warehouse and jewelry being appraised. For the four jewelry transfers we reviewed, appraisals ranged from 7 to 126 days later.

Figure 4. Example Photo of Bundled Jewelry Auction



SOURCE: Auditor analysis of City auctions on PublicSurplus.com.

Using a dual custody safe, as other departments use for storing cash deposits, would help ensure items do not go missing before they are appraised. As well, having a separate Purchasing staff hold the second safe key or combination could also help improve separation of duties.

Due to the volume of individual items, more detailed recordkeeping could be very time consuming. Establishing appropriate separation of duties represents the most efficient method of achieving controls.

2. In testing 30 non-jewelry Property & Evidence surplus items, we found 2 auctions that were inconsistent with the Property & Evidence transfer documents:
 - One auction was referenced for two items that Property & Evidence labeled as a “golf club and black bag” and “4 golf clubs in Taylor Made bag.” However, that auction’s photos (copied here in Figure 5) showed 1 Taylor Made Firesole golf bag with 5 clubs in total. The warehouse technician who posted the auction photos confirmed that there was only 1 golf bag auctioned as described

Figure 5. Photos of Golf Bag and Clubs



SOURCE: Auditor analysis of City auctions on PublicSurplus.com.

in the auction details. However, the Warehouse Manager emailed that “It appears there are two different black bags in the photos, one says TaylorMade the other is not clear starts with a for***** 5 total clubs, 2nd bag not listed...”.

- One auction was referenced for 4 items that Property & Evidence labeled as 3 Taser guns and 1 Taser gun battery. However, the auction photo showed 3 Taser guns: 2 showing visible batteries and 1 visibly showing no battery inserted. The Warehouse Manager stated that there was an additional battery in the Property & Evidence items that had not been listed on the transfer document.
3. Our review of the Information Technology department’s surplus equipment items also identified inconsistencies between the transfer paperwork and auction documentation:

- One auction listed 16 monitors and 6 servers in a lot, although the property transfer sheet indicated 17 monitors and 9 servers. The Warehouse Manager stated that there were 17 monitors and 9 servers in the auction and the auction description was inaccurate. It is unclear how many monitors and servers the auction winner received. An example Auction photo is shown in Figure 6.
- In several instances, we noted equipment auctioned that was not listed on transfer paperwork, including a television, a paper shredder, a camera, a video camera, a printer, and a network switch. According to Warehouse staff, the surplus IT items are not reviewed closely when the transfer is accepted. The Warehouse Manager also stated that discarded electronic devices sent to the Warehouse are sometimes added to the IT auctions rather than sending the items to the landfill. This practice has not been documented.

Figure 6. Example Photo of Monitors and Servers



SOURCE: Auditor analysis of City auctions on PublicSurplus.com.

To maintain accountability for the items it receives, the Warehouse should match the items to the corresponding paperwork and follow up with the originating department to clarify any inconsistencies.

- B. Fleet vehicles and equipment transferred to the Warehouse should be recorded and policies regarding title transfer need to be followed.
- When Fleet decommissions vehicles and sends them to the Warehouse for auction, the vehicles are dropped off with the signed title, keys, and specification sheet. The vehicle or equipment is parked in the yard just outside of the Warehouse and the title and keys are kept in the Warehouse office. The Warehouse does not record when these items are received or keep an inventory of them. According to staff, they do not hold Fleet auctions as they do other auctions but, instead, will typically upload and release these as soon as they can get to it. It is unclear how long this process takes because the date the property is transferred to the Warehouse is not documented. But in the 7 reviewed Fleet auctions that involved a vehicle title, the title had been signed off 14 to 299 days before the auction date.

- The City’s terms and conditions, as well as other Valley cities’ terms outlined on the Public Surplus auction website, state that open vehicle titles will not be issued. An open vehicle title means that the “buyer” information has been left blank. Despite this stated policy, the Warehouse currently leaves the buyer information blank on the title and when recording the vehicle as sold through the Arizona Motor Vehicles Division. This practice could allow buyers to avoid paying registration and sales taxes.
- C. Transaction privilege tax (TPT) exemptions were given without verification. During FY 2017/18 and FY 2018/19, the Warehouse Manager and Sr. Stock Clerk authorized a total of \$500,000 in tax-exempt transactions without verification. Without documentation of the buyers’ tax-exempt status, the City could be liable for more than \$40,000 in TPT.

The City’s auction page states that sales tax will be collected unless the buyer provides the City with a valid tax-exempt certificate prior to payment. However, the Warehouse Manager indicated this verification has not actually been required. Also, resellers may be tax-exempt only if the specific item is purchased for resale. To validate this, an Arizona Resale Certificate needs to be completed describing the nature of the business and the property being purchased. These certificates were not obtained. Further, TPT exemptions may have also been given for invalid reasons. For example, some buyers who registered with the online auction site using out-of-state addresses have been given exemptions even though the items are sold and picked up in Scottsdale.

- D. Auction refunds do not comply with the stated terms, and they are not adequately documented to ensure their validity.

Although the City’s auction terms state that no refunds will be given, the Warehouse Manager has approved refunds for various stated reasons, including customers that paid but did not pick up their items within the 7 calendar days. We tested 4 auction refunds of the 18 issued during the two-year period. For these 4, we found no documentation of the buyer’s request for refund, limited or no information about the reason for the refund, and no formal documentation or approval process. For a \$3,300 refund, there was also no documentation of whether the item was returned. For this refund, auction notes state that the Warehouse Manager and the Purchasing Director authorized the refund and the Sr. Stock Clerk processed it.

AR 268, Cash Handling, requires the reason for refunds to be documented and the request dated and signed by the patron requesting the refund; supervisory review is also required.

- E. The Warehouse Manager has delegated some surplus disposal responsibilities to other departments.

City code provides that no other department besides Purchasing may transfer, sell, trade, loan give away or otherwise dispose of property owned by the city. However, the Warehouse has delegated some surplus disposal responsibilities to two other departments:

- Since January 2018, the Warehouse has asked the IT department to not send surplus Apple devices for auction because the items were not consistently unlocked for resale. Instead, the Warehouse Manager asked that the IT department destroy these items. The IT department reported that it has not yet destroyed the Apple devices, citing that this should be done by a contractor that can certify destruction because the devices may contain sensitive data. Contracting for secure destruction is a responsibility more

appropriately handled by the Purchasing department and/or Warehouse based on City code provisions.

- By agreement of the Warehouse and Police department, unclaimed vehicles being released through Property & Evidence are not sent to the Warehouse. Instead, they are towed and auctioned by a third-party company contracted by the Police department. This contractor charges a fee to file for the vehicle title and tow the vehicles to its own location for auction.

The Warehouse Manager stated he would also prefer not to receive damaged surplus property or “junk” because it would have to be picked up and then thrown in the trash. However, centralized disposal reduces the risk of employees throwing away items that may still have value. For example, the Warehouse auctions lots of used batteries and print cartridges because these are often purchased by recyclers. As well, it also allows a centralized auction process and combined lots that may result in higher sales prices. Further, a City Code revision would be needed before other departments are authorized to dispose of surplus property.

F. Adjusting certain practices may increase auction sales revenue.

While reviewing auction details and current practices, we observed areas where adjustments may increase auction revenues:

- Limited pickup times may deter some buyers from bidding.

Currently, the Warehouse’s policies on the online auction site state that buyers must pay and pick up auction items within 7 calendar days of receiving the award notification. However, the specified pick-up times are limited to Tuesdays, Wednesdays, and Thursdays from 9 a.m. to 1:30 p.m., a substantially short period for buyers to get the purchased items. Other Valley cities using the Public Surplus auction site listed pick-up deadlines of 2 weeks and their facilities were generally open 4 to 5 days a week with longer hours.

- “Reserve” amounts or other disposition methods may be beneficial for more valuable items.

The Public Surplus site allows the City to set a reserve amount or minimum bid that must be met before the City will sell the item. Since the Warehouse sets most auctions to be open for only 7 days, it may be beneficial to set reserve amounts for more valuable items rather than simply accept the highest amount bid within a few days. For example, the Warehouse auctioned a 5-year old book sorting system described as “in working condition when removed from service” for only \$26. Alternatively, other methods of disposal, such as soliciting offers to purchase or trading the property for credit against new purchases, may be more advantageous in some instances. Researching the fair market value of more significant items may assist in making these decisions.

- Grouping items into large, unidentifiable lots may discourage buyers.

Adding brands, model numbers, and other information about surplus items could increase interest in the auctions and the resulting bid amounts. Often the department releasing an item as surplus provides no description and the Warehouse staff would have to do additional research to more completely describe the item.

As shown in Figure 7 on page 19, this can result in auction lots where the included items are not clear or identifiable. For example, the IT department’s transfer paperwork does not

contain brand or model information, even though the department maintains a detailed inventory of the City’s technology equipment. As well, the department ensuring the power cords are attached to the correct equipment and providing a general condition statement could increase auction prices.

Figure 7. Examples of Auction Lot Photos



SOURCE: Auditor analysis of City surplus auctions on PublicSurplus.com, with auction titles.

Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Obtains documentation of all jewelry that the contracted appraiser has reviewed; implements appropriate segregation of duties including assigning an employee who is not involved with the auctions to serve as an independent asset custodian; uses a dual custody safe to store valuable items; verifies counts and descriptions of surplus IT items when they are received and documents any discrepancies; and documents the source of any additional items that are included in the auctions.

- B. Maintains an inventory of Fleet vehicles received for auction, records the date on which the vehicles are received by the Warehouse and discontinues the practice of issuing open vehicle titles.
- C. Requires buyers to submit appropriate documentation before granting tax-exemptions and appropriately maintains the documentation in Warehouse files.
- D. Modifies the auction terms to note when refunds may be given. In addition, the Warehouse Manager should require any refund request to be submitted in writing and properly documented in accordance with AR 268, *Cash Handling*.
- E. Takes responsibility for destruction and disposal of all City surplus property as required in City Code, including developing or contracting a method for secure destruction of surplus technology items that cannot be sold and managing the auctions of any unclaimed vehicles released through Police Property & Evidence.
- F. Establishes longer hours for buyers to pick up auction items, sets reserve amounts for more valuable items, and requests departments to submit more specific descriptions of auction items.

3. The Warehouse could more efficiently promote internal surplus property transfers as prioritized in City Code.

Although City Code requires that surplus items be made available internally prior to any other disposition, the Warehouse's policies and practices do not comply with this requirement. There are no procedures regarding how long surplus items should be held prior to listing them for auction and the availability of these items is not communicated to City departments.

- Surplus property availability is not effectively communicated to City staff, and the Warehouse did not compile a complete listing of available items.

In 2016, following the City Auditor's 2015 review of surplus property, Purchasing created a Sharepoint listing of available surplus items. This Sharepoint site also included a form for employees to request needed items or to request surplus pick-ups. The surplus listing appears to have been maintained until July 2017, with 322 items listed between January 2016 and July 2017. Between August 2017 and July 2019, only one additional surplus item was listed.

Returning to practices used prior to the 2015 review, the Warehouse requires City employees to call or email to ask about specific items. Occasionally, if an item that would fulfill a request had already been uploaded to the online auction, the Warehouse Manager or Sr. Stock Clerk would stop that auction to transfer the item to a department for City use.

- The Warehouse does not maintain a complete listing of surplus property received and their dispositions, or a list of items that are available at any given time.

When the Warehouse receives or picks up surplus items, the current procedure is for the Warehouse staff to complete and attach a surplus tracking form. This paper form is supposed to stay with the item until its disposition through auction, transfer, or landfill. However, we observed items held at the Warehouse that did not have these filled out forms

attached. As well, the forms are not numbered or otherwise tracked and may easily be lost or thrown out.

- Making surplus items available for City use before auctioning could result in cost savings for the City.

We noted instances where items commonly used by City departments were auctioned. For example, the Warehouse auctioned a pallet of nitrile gloves surplused by the Police department. These gloves were nearly identical to gloves purchased and stocked in the Warehouse Stores for City use. The pallet containing about 25 cases of nitrile gloves sold for \$455, or less than \$20 per case. However, the Warehouse purchases nitrile gloves for about \$70 per case for the Stores supplies, so the City could have saved about \$1,300 on this item alone.

In reviewing the current auction provider's service contract, we noted that Public Surplus offers a free "Internal Reallocation" service. This service would allow City departments to upload their surplus property items, along with photographs and descriptions, to the auction site. The Internal Reallocation site would only be viewable by City departments for no-cost "bids" to obtain the items.

If surplus items are not claimed by departments, this internal auction can be updated to become a public auction. This service could potentially reduce the Warehouse's workload in creating auctions, allow departments to provide more descriptive information about their surplus items than Warehouse staff knows, and reduce surplus pick-up/delivery transfers if the items remain with the originating department until after the Internal Reallocation period. As well as being more efficient, this service would provide improved documentation and accountability for internal surplus property.

Recommendation:

The Purchasing Director should ensure the Warehouse Manager establishes a method to make City departments aware of available surplus items and maintains an inventory of surplus items as they are received and disposed.

4. Other Warehouse functions and responsibilities need to be clarified or strengthened.

In addition to issuing supplies and disposing of surplus items, the Warehouse stores some items for other departments and arranges City shipments. However these tasks are not handled consistently for all departments.

- A. Responsibilities over record-keeping and asset accountability for warehoused goods need to be established.

Various City departments store spare parts, supplies, and materials in the Warehouse, subject to the Warehouse Manager's approval. According to the Warehouse staff, they assist the owner departments by using forklifts to move items as needed, but they do not maintain records of these items. The owner departments are responsible for any recordkeeping associated with the stored items.

An exception is made for the water meter stock, which can cost anywhere from \$55 to \$6,300 per item. Because water meter purchases are directly received at the Warehouse, the Warehouse staff tracks the quantities received and meters issued to Water staff. This information is then provided to the Water department for its inventory records. As well, the Warehouse Manager periodically counts the on-hand meters to compare to his records and updates the Water staff on the results.

Based on interviews, the other departments are not itemizing and inventorying their stored items other than the Street Operations department, which reported it verifies stored signage materials on a quarterly basis.

Further, since the Warehouse does not keep records of the stored items, it is sometimes not clear which department owns particular items. For example, a group of display cases, was accidentally uploaded for surplus auction then removed when someone recalled that the items were just being stored. Although we were told the display cases belong to the Library, the Library Director thinks they belonged to Communications. Because stored items and surplus items are sometimes placed together, there is an increased risk that stored items will be accidentally auctioned or surplus items will remain sitting in the Warehouse unsold.

B. Shipping responsibilities may be more effectively managed by departmental staff.

Part of one Warehouse staff's responsibilities includes paying City shipping charges through his procurement card and scheduling the package pickups. In FY 2018/19, this staff charged 134 shipping transactions totaling about \$3,800 to various department cost centers.

- According to the Warehouse staff, all departmental shipping should go through the Warehouse, however, we could not locate such a policy. Further, there are no shipping restrictions in the procurement card system, and other cardholders also charged shipping costs during the past year.
- As well, Warehouse staff indicated that other departments probably received notification of their shipping charges that he paid. However, the procurement card system only sends an automated notification to the cardholder's immediate supervisor, and the supporting invoices are only submitted to the cardholder's immediate supervisor. Other departments would not receive the shipping charge details for review unless they noticed the charge and requested documentation from the Warehouse staff.

Given the timely, detailed notification of charges through the procurement card system, it is more effective to have departments pay their own shipping charges so that supervisors have more specific information to directly review these costs. As well, package pickups are generally available at most locations.

Examples of property stored at the Warehouse:

- Water meters, valves and materials
- Street signs and marking materials
- New and used spare parts for Traffic signals, controllers, and cameras
- Spare parts removed from equipment by Facilities
- Fire foam, spare equipment, old uniforms waiting for destruction
- Airport supplies used for conventions
- Parks & Recreation new, uninstalled diving boards
- Display cases (department undetermined)
- Miscellaneous promotional materials

SOURCE: Auditor observations and inquiries.

Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Maintains an inventory of items stored for other departments and annually reviews the inventory with those departments to determine whether the items should continue to be stored, be made available to other departments, or be disposed through the auction.
- B. After informing the affected departments, discontinues shipping for other departments unless there are special requirements that can only be handled by Warehouse staff.

MANAGEMENT ACTION PLAN

1. Management has not established appropriate controls to manage its Stores operations.

Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Requires staff handling the inventory transactions to input them directly into SmartStream as they occur to increase accountability and efficiency.
- B. Requires staff to issue receipts to assist departments in reviewing supply usage and appropriately document returns and refunds with transaction and requester details for manager approval.
- C. Adopts policies and procedures to ensure that inventory counts are conducted and documented properly, including documentation of inventory adjustments and management approval.
- D. Requires staff to modify the inventory system information so that the item units match the units that are typically issued.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Purchasing Department will examine a consolidated approach to improving the controls associated with the Stores operation. Inventory tracking and transaction management is currently a manual process which presents challenges to immediate implementation. Warehouse staff balances time between internal services such as stocking supplies needed for daily City operations, storing City property for other departments, collecting and processing surplus property and receiving goods shipped to the Warehouse as a centralized City address and providing external services to the public such as operating the auction and remaining available for receiving shipments. Critical to balancing these services, the Stores operations has maintained a simple approach based on paper processes. A consolidated approach will focus on identifying available automated inventory systems that immediately updates inventories, provides receipts for transactions and helps manage inventory system information with the benefits of conserving staff time to ensure other Warehouse services and responsibilities are maintained. Many automatic systems offer hand-held scanners, standardized transaction reporting and other functions currently pursued manually. Systems will be analyzed according to efficiencies meeting the best interest of the City including budget availability. An automated inventory systems solution will be recommended along with an implementation strategy by the close of the current fiscal year.

RESPONSIBLE PARTY: Warehouse Manager

COMPLETED BY: 6/1/2020

2. Surplus property policies and procedures are not consistently followed, and practices could be improved.

Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Obtains documentation of all jewelry that the contracted appraiser has reviewed; implements appropriate segregation of duties including assigning an employee who is not involved with the auctions to serve as an independent asset custodian; uses a dual custody safe to store valuable items; verifies counts and descriptions of surplus IT items when they are received and documents any discrepancies; and documents the source of any additional items that are included in the auctions.
- B. Maintains an inventory of Fleet vehicles received for auction, records the date on which the vehicles are received by the Warehouse and discontinues the practice of issuing open vehicle titles.
- C. Requires buyers to submit appropriate documentation before granting tax-exemptions and appropriately maintains the documentation in Warehouse files.
- D. Modifies the auction terms to note when refunds may be given. In addition, the Warehouse Manager should require any refund request to be submitted in writing and properly documented in accordance with AR 268, *Cash Handling*.
- E. Takes responsibility for destruction and disposal of all City surplus property as required in City Code, including developing or contracting a method for secure destruction of surplus technology items that cannot be sold and managing the auctions of any unclaimed vehicles released through Police Property & Evidence.
- F. Establishes longer hours for buyers to pick up auction items, sets reserve amounts for more valuable items, and requests departments to submit more specific descriptions of auction items.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: Surplus property management has always been a significant portion of the Warehouse surplus property role. The auction services (as a component of surplus property management) has developed some challenges in part because of its success. As indicated in this audit report, revenue provided to the general fund has increased. The Warehouse staff dedicated increasingly more time and attention to sorting through surplus property while processing and preparing items for auction to ensure the maximum benefit is received by the City. In addition to this continued effort, it is time to examine the process and procedures for this service in order to accommodate continued success. It is important to consider accuracy in addition to volume for the auction program. Procedures shall be established that integrate already existing fragmented processes that only address isolated steps in the surplus chain of custody as well as integrating City policies such as the referenced AR 268. While updating procedures, Purchasing management will reach out to other departments such as Fleet, Police, Information Technology and Water to coordinate improved controls while maintaining cross-department operational efficiencies. A committee will be assembled to pursue a solution that addresses these recommendations and drafts a process that encompasses surplus property handling from the beginning (transferred from department to warehouse) to the conclusion (destruction or

auction). The committee will be formed before the end of the calendar year with the immediate goal of integrating these specific recommendations into the improvement strategy priority list. These established processes will be promoted and enforced by the Warehouse Manager within the daily operations of surplus management.

RESPONSIBLE PARTY: Warehouse Manager

COMPLETED BY: 12/1/2020

3. The Warehouse could more efficiently promote internal surplus property transfers as prioritized in City Code.

Recommendation:

The Purchasing Director should ensure the Warehouse Manager establishes a method to make City departments aware of available surplus items and maintains an inventory of surplus items as they are received and disposed.

MANAGEMENT RESPONSE: Agree

PROPOSED RESOLUTION: The Warehouse has recently updated its inventory list of available surplus items for any City department to utilize. The Warehouse Manager will immediately work with the Purchasing Technology Specialist to proactively promote the list through internal communications. In order to provide a more robust, interactive and available surplus property list, the Warehouse Manager shall identify and compare options and opportunities to promote an internal reuse program. The focus of the solution is promoting a convenience which enhances surplus property reuse by other departments rather than mandating surplus property utilization. Recommended improvements will be provided to the Purchasing Director for implementation in the next fiscal year.

RESPONSIBLE PARTY: Warehouse Manager

COMPLETED BY: 6/1/2020

4. Other Warehouse functions and responsibilities need to be clarified or strengthened.

Recommendations:

The Purchasing Director should ensure the Warehouse Manager:

- A. Maintains an inventory of items stored for other departments and annually reviews the inventory with those departments to determine whether the items should continue to be stored, be made available to other departments, or be disposed through the auction.
- B. After informing the affected departments, discontinues shipping for other departments unless there are special requirements that can only be handled by Warehouse staff.

MANAGEMENT RESPONSE: Partially Agree

PROPOSED RESOLUTION: The warehouse as a function (actions such as receiving and shipping) and as a location (City facility for storage) serves a primary purpose in the supply chain function for critical City services. Balancing these two aspects will be a fundamental component to warehouse operation improvements and is represented in these two specific recommendations. However, further review of Warehouse roles and responsibilities is needed before discontinuing any one service provided. Although not opposed to the decentralization of shipping with regards to the more common situation of immediately returning purchased items for various reasons (known as *returns*), the impact to shipping costs controls as well as the administrative changes affecting Procard use is unknown at this time. The immediate action for this recommendation will be to inventory all responsibilities of the Warehouse and classify these under the core processes as identified in this report. Maintaining the inventory of items within the physical location of the warehouse but not under the Warehouse Manager's authority will be one of the many responsibilities listed. Likewise, the recommendation concerning returns will be integrated. The purpose is to clearly identify the Warehouse Manager's role in maintaining internal services for other departments and prioritizing these according to the current needs of City operations. This action serves to develop a comprehensive identification of Warehouse functions and responsibilities before specific tasks are identified to be discontinued.

RESPONSIBLE PARTY: Warehouse Manager

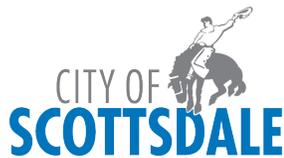
COMPLETED BY: 6/1/2020

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