



STATE OF OKLAHOMA SPECIAL AUDIT

Audit Summary

The results of this audit identify weaknesses in the Department of Transportation's controls over inventory.

Key Issues from the Report

- **The Department does not appear to have adequate controls over inventory**
 - Lack of comprehensive policies and procedures – Page 3;
 - Inadequate physical security of assets – Page 4;
 - Inadequate controls over keys to inventory areas – Page 5.

- **Trends were noted regarding inventory shortages**
 - Nine inventory items appeared to be consistently short – Page 6.

- **The Department appears to be expending public funds for services not relied upon**
 - The Department paid approximately \$56,775 to RGIS (Retail Grocery Inventory Service) for fiscal years 1999 – 2003 to perform inventory counts that were not consistently relied upon to adjust inventory records. This appears to be an inefficient use of public funds and resources – Page 8.

JEFF A. McMAHAN, CFE

OFFICE OF THE
STATE AUDITOR & INSPECTOR

Why the audit was performed

This special audit was conducted as a result of information obtained during the course of our regular audit of the Department of Transportation.

Audit Objectives

The objectives were to:

1. Review agency employee access to assets in both division and field warehouses.
2. Perform an analysis of inventory shortages.

**OKLAHOMA DEPARTMENT OF TRANSPORTATION
SPECIAL AUDIT REPORT
FOR THE PERIOD JULY 1, 1998 THROUGH JUNE 30, 2003**

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October 1, 2004

**TO THE MEMBERS OF THE
OKLAHOMA DEPARTMENT OF
TRANSPORTATION COMMISSION**

Transmitted herewith is the report for the special audit of inventory controls for the Oklahoma Department of Transportation. The procedures we performed were conducted as a result of information we obtained during the course of our regular audit.

The Office of the State Auditor and Inspector is committed to serve the public interest by providing independent oversight and by issuing reports that serve as a management tool to the State. Our goal is to ensure a government that is accountable to the people of the State of Oklahoma.

We wish to take this opportunity to express our appreciation to the agency's staff for the assistance and cooperation extended to our Office during the course of our special audit.

Sincerely,

A handwritten signature in cursive script that reads "Jeff A. McMahahan".

JEFF A. McMAHAN
State Auditor and Inspector

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Background

The Oklahoma Department Of Transportation (ODOT) was created by the Legislature in 1976 as an overall coordinating agency for the state's highways, railways, and waterways; this agency superceded the original Oklahoma State Department of Highways, implemented by legislation in 1911. The Oklahoma Aeronautics Commission, the Oklahoma Highway Safety Office, and Rail Planning were also placed under ODOT jurisdiction. Highway Safety was transferred to the Oklahoma Department of Public Safety in 1993. The Waterways Branch was transferred from the Commerce Department to ODOT in 1993. The Oklahoma Aeronautics Commission became its own agency in 2002. The Department is primarily funded by motor vehicle fuel taxes, legislative appropriations and a return of federal matching dollars from the Federal Highway Trust Fund. ODOT's annual budget, totaling more than \$1 billion in federal and state funds, is applied to highway construction and maintenance activities, railways, waterways, public rural transit programs and administration statewide. While the primary business is construction and maintenance of the state's highways, the agency also promotes intermodal transportation. An eight-member Transportation Commission appointed by the Governor and confirmed by the Senate sets departmental policy and oversees general operations. The members represent eight geographic districts corresponding with ODOT's eight Field Divisions.

The mission of the Department is to provide a safe, economical, and effective transportation network for the people, commerce, and communities of Oklahoma.

Commission Members

Prior to February 2003

Herschel Crow Secretary of Transportation

Prior to May 2003

Tom Love, District IV Chairman
Ed Sutter, District VI Vice Chairman
David Burrage, District II Secretary
Carlisle Mabrey, District I Member
Jimmie Austin, District III Member
Bill Crawford, District V Member
Gib Gibson, District VII Member
Guy Berry, District VIII Member

Effective February 2003

Phil Tomlinson Secretary of Transportation

Effective May 2003

Dan Overland, District III Chairman
James H. Dunegan, District II Vice Chairman
Jack Begley, District VI Secretary
Jackie Cooper, District IV Member
Larry Wade, District V Member
Brad Burgess, District VII Member
Guy Berry, District VIII Member
Carlisle Mabrey, District I Member

Scope

The objectives of our engagement were to:

1. Review employee access to assets stored in both division and field warehouses.
2. Perform an analysis of inventory shortages noted for fiscal years 1999 through 2003.

<i>OBJECTIVE #1</i>	Review employee access to assets stored in both division and field warehouses.
<i>Criteria</i>	Effective internal controls are necessary to ensure proper stewardship and accountability of publicly owned assets.
<i>Methodology</i>	<p>To determine whether or not there were effective controls over employee access to assets stored in both division and field warehouses, we performed the following procedures:</p> <ol style="list-style-type: none">1. We reviewed the Department's policies and procedures regarding purchasing, receiving, controlling, and distributing of inventory.2. We sent out surveys to a sample of employees (both supervisory and non-supervisory) regarding their access to inventory.3. We performed site visits of a sample of division and field warehouses to determine whether controls over employee access to assets existed and were operating effectively.

Based on the procedures performed above, we noted the following:

Lack of Comprehensive Policies and Procedures

<i>Condition</i>	<p>During our review of the Department's policies and procedures, we determined that there are no formal written policies or procedures regarding the following:</p> <ol style="list-style-type: none">1. Security and access to inventory.2. Procedures for the adjustment of inventory records based on variances noted during physical inventory counts.3. Procedures to ensure inventory transactions are processed properly, inventory amounts are reported fairly, and inventory is adequately safeguarded.<ol style="list-style-type: none">a. During site visits of sixteen (16) warehouses, we noted that three (3) of the warehouses were either removing inventory items from the inventory records before the items were issued or were not entering items on the inventory records when they were received. We specifically noted the following:<ol style="list-style-type: none">1. Hydro Field Storage Unit – Inventory items such as oil filters, belts, hoses, etc. are removed from inventory and placed on a shelf behind the office door for easy access.
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2. **Lawton Storeroom B** – Items in Storeroom B have been incorrectly removed from the inventory records.
3. **Taloga Field Storage Unit** – Tires received from the main warehouse are not placed on the Taloga Field Storage Unit's inventory records. The unit only maintains a log of the tires used.

The conditions noted above would also seem to indicate that the Department has not comprehensively addressed repeat finding #99-345-007 issued by the State Auditor and Inspector regarding the need to establish and maintain a system of internal controls designed to safeguard inventory.

Effect

Inventory may not be adequately safeguarded and may be more susceptible to misappropriation. In addition, inventory amounts reported may be more susceptible to misstatement.

Recommendation

We recommend that the Department develop and implement comprehensive policies and procedures regarding: (1) security and access to inventory; (2) procedures for the adjustment of inventory records based on variances noted during physical inventory counts; and (3) procedures to ensure inventory transactions are processed properly and inventory amounts are reported fairly.

Inadequate Physical Security of Assets

Condition

During site visits of sixteen (16) warehouses, we noted that ten (10) warehouses had inadequate physical security of assets as documented below:

1. **Antlers Main Warehouse** – Stockpiles of aggregate were unsecured at the intersection of HWY2/HWY 271 N. and HWY 271 S.
2. **Buffalo Field Storage Unit** – Workers are allowed unsupervised access to inventory.
3. **Checotah Field Storage Unit** – There is no control over fuel access. Employees are allowed unsupervised access to the fuel bays.
4. **Hugo Field Storage Unit** – Stockpiles of aggregate located outside of the perimeter fence of the unit yard were unsecured.
5. **Hydro Field Storage Unit** – Herbicides and aggregate were stored in an unsecured area. In addition, some inventory still on-site had already been removed from inventory records “in case someone needs something in a hurry”.
6. **Lawton Field Storage Unit** – There is no control over fuel access. Employees are allowed unsupervised access to the fuel bays.
7. **OKC Central Sign Shop** – Workers are allowed unsupervised access to inventory.
8. **OKC Central Garage** – Workers are allowed unsupervised access to inventory.
9. **Taloga Field Storage Unit** – Sign material located in front of the employee and public parking area was unsecured.

10. **Wagoner Field Storage Unit** – There is no control over fuel access. Employees are allowed unsupervised access to the fuel bays.

Effect Inventory may not be adequately safeguarded and may be more susceptible to misappropriation.

Recommendation We recommend that the Department develop and implement comprehensive policies and procedures regarding the physical security of inventory.

Inadequate Controls Over Keys to Inventory Areas

Condition During our testwork, we noted that the Department has not established comprehensive policies and procedures regarding control over keys to inventory areas. In addition, during site visits of sixteen (16) warehouses, we noted the following:

The following thirteen (13) warehouses had keys to the inventory areas that were not marked “Do Not Duplicate”:

1. Antlers Main Warehouse
2. Buffalo Field Storage Unit
3. Checotah Field Storage Unit
4. Chickasha Field Storage Unit
5. Hugo Field Storage Unit
6. Wagoner Field Storage Unit
7. Hydro Field Storage Unit
8. Lawton Field Storage Unit
9. Muskogee Main Warehouse
10. OKC Central Stockroom
11. OKC Central Garage
12. Taloga Field Storage Unit
13. Wilburton Field Storage Unit

The following seven (7) warehouses had keys to the inventory areas issued to employees that were not responsible for the inventory items:

1. Buffalo Field Storage Unit
2. Hydro Field Storage Unit
3. Lawton Field Storage Unit
4. OKC Central Garage
5. OKC Central Stockroom
6. OKC Central Sign Shop
7. Wilburton Field Storage Unit

The following four (4) warehouses had extra keys to the inventory areas that were not adequately secured to prevent unauthorized access:

1. **Chickasha Field Storage Unit** – Board used to hold keys to equipment also has keys to inventory areas such as the river yard and sign shop. This board is maintained in the open shop and is accessible to all employees.

2. **OKC Central Garage** – The keys to all on-site ODOT vehicles are located in an unlocked box in the secretary’s office and are accessible to all employees.
3. **OKC Central Stockroom** – The key to the plotter paper room is stored on the wall inside the central stockroom and is accessible to all employees.
4. **Taloga Field Storage Unit** – Two (2) extra keys are kept in the unlocked desk of the superintendent and are accessible to all employees.

The following three (3) warehouses did not have procedures in place to retrieve keys from terminated employees:

1. Hydro Field Storage Unit
2. Lawton Field Storage Unit
3. OKC Central Sign Shop

Effect Lack of comprehensive controls over keys to inventory areas may allow unauthorized individuals access to inventory. The lack of controls in this area increases the susceptibility of inventory to misappropriation or misstatement.

Recommendation We recommend that the Department develop and implement comprehensive policies and procedures regarding control over keys to inventory areas.

OBJECTIVE #2 Perform an analysis of inventory shortages noted in recent fiscal years.

Criteria Effective internal controls are necessary to ensure proper stewardship and accountability of publicly owned assets.

Methodology We obtained the RGIS Inventory Services physical inventory count reports for fiscal years 1999 through 2003. From these reports, we performed an analysis of the shortages to determine if there were any trends or patterns in shortages. Based on this analysis, we did not note any trend or pattern of shortages related to any specific division or location within the Department. However, we did note that the following nine (9) inventory items appeared to be consistently short:

1. Aggregate
2. Auto Batteries
3. Diesel Fuel
4. Galvanized Steel Posts
5. Motor Oil
6. Tires
7. Unleaded Gasoline
8. Weed Eater Line
9. Weed Killer

Based on this analysis, we structured our division and field warehouse site visits related to Objective #1 above to include procedures to determine whether there were adequate

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controls over employee access to inventory for these nine (9) items and other inventory items. In addition, we noted in our testwork related to Objective #1 above that the Department does not have specific policies or procedures for the adjustment of inventory records based on variances noted during physical inventory counts. See findings above.

Additional Finding and Recommendation

<i>Criteria</i>	A basic component of governmental accountability is the appropriate and efficient use of public funds and resources by an entity in executing its duties and responsibilities.
<i>Condition</i>	<p>We noted during the course of our testwork that the Department contracts with RGIS (Retail Grocery Inventory Service) to perform physical inventories at ODOT division and field warehouses. RGIS is one of the leading third-party providers of inventory services in the United States and has been in operation since 1958.</p> <p>The Department paid approximately \$56,775 to RGIS for the time period of July 1, 1998 to June 30, 2003. However, based on our testwork, it appears the Department does not consistently rely on the inventory counts performed by RGIS to adjust inventory records. In addition, the Department was unable to provide three of the sixty-one RGIS physical inventory variance reports requested by our auditors.</p>
<i>Effect</i>	The Department appears to be expending public funds and resources for services that the Department does not rely upon. This appears to be an inefficient use of public funds and resources.
<i>Recommendation</i>	We recommend that the Department reassess the appropriateness of hiring RGIS to perform inventory counts. If a determination is made that the services provided by RGIS are not reliable, the Department should consider obtaining an alternate source for the services. Further, we recommend the Department consider in general the necessity of using a third-party source for services that could be provided by Department personnel resulting in savings to the Department.

Department of Transportation Response

Lack of Comprehensive Policies and Procedures

- (1) **Security and access to inventory** – The Maintenance Division will submit to Senior Staff for approval policy and procedures regarding the security and access, and transaction processing of Department inventory by March 1, 2005.
- (2) **Procedures for the adjustment of inventory records based on variances noted during physical inventory counts** – The Comptroller Division, who is responsible for initiating the adjustments, has maintained written procedures for this activity for some time. A copy of these procedures is being provided to the Auditor for review.
- (3) **Procedures to ensure inventory transactions are processed properly and inventory amounts are reported fairly** – The Maintenance Division will submit to Senior Staff for approval policy and procedures regarding the security and access, and transaction processing of Department inventory by March 1, 2005.

Inadequate Physical Security of Assets

Develop and implement comprehensive policies and procedures regarding the physical security of inventory – The Maintenance Division will submit to Senior Staff for approval policy and procedures regarding the security and access, and transaction processing of Department inventory by March 1, 2005.

Inadequate Controls Over Keys to Inventory Areas

Develop and implement comprehensive policies and procedures regarding control over keys to inventory areas – The Maintenance Division will submit to Senior Staff for approval policy and procedures regarding the security and access, and transaction processing of Department inventory by March 1, 2005.

Additional Finding and Recommendation

Reassess the appropriateness of hiring RGIS to perform inventory counts. Consider in general the necessity of using a third-party source for services that could be provided by Department personnel resulting in savings to the Department. – Prior the selection of RGIS to perform the warehouse inventories the Department used four (4) full time personnel to complete this task. On the average, the time and effort required to completing the inventory of the eight (8) field warehouses and three (3) central office warehouses amounted to 32 man months. With this process in place the inventory personnel were in the field warehouse for most of month, finding themselves in the way of the warehouse personnel who were trying to complete their daily operations. This fact, along with the cost incurred which would amount to approximately \$150,000 annually, caused the Department to seek more efficient methods for completing the annual inventory.

The selection of RGIS brings about efficiency of the process in that the entire annual inventory is completed in nine (9) days rather than eight (8) months. The annual cost is significantly lower given the five (5) year cost identified by the Auditor of \$56,775 for the RGIS contract as compared to the one-year cost of having ODOT employees at \$150,000.

During the 2003 inventory the Comptroller found that RGIS did not fulfill all of the requirements of the contract during two (2) inventories that caused confusion during the record adjustment process. RGIS has assured the Comptroller that this was an isolated incident and that the terms of the contract will be fulfilled completely from this point forward.