

LOS ANGELES COUNTY

ECONOMY AND EFFICIENCY COMMISSION


ROOM 163, HALL OF ADMINISTRATION / 500 WEST TEMPLE / LOS ANGELES, CALIFORNIA 90012 / 974-1491

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TO: Each Supervisor

FROM: Joe Crail, Task Force Chairman
John Campbell, Executive Secretary 

SUBJECT: MATERIALS MANAGEMENT AND INVENTORY CONTROL

Work Performed

Since initiating our review, we have conducted eighteen interviews of County officials who have responsibilities with substantial impact on materials management or the security of equipment and supplies. We have discussed alternative approaches with two private sector experts and initiated contact with several others. We have reviewed documentation of the County's current system and the financial background. We have determined the extent to which the County has identified and addressed problems in this area in the past. We have obtained information on corrective action implemented by County officials and on plans for systems development.

The remainder of this memorandum contains an outline of our findings and conclusions to date.

Nature and Extent of the Problem

In 1978, Los Angeles County initiated change of its financial accounting policies to conform with generally accepted accounting principles and to procure an audit of its statements by independent certified public accountants. In 1979, the independent auditor expressed no opinion on the balance sheet of the General Fixed Assets Account Group because the information available was insufficient to substantiate the acquisition costs of the County's property and equipment. In addition, some of the experts we interviewed expressed doubt that the County has comprehensive information on the property it owns and the supplies it consumes.

Qualified by those reservations, the County reported \$196 million in equipment and \$34 million in inventories as of June 30, 1980. Recent County expense plans include \$100 million for equipment and \$180 million for supplies.

Recent attention to materials management by County managers, internal auditors, consultants, and Grand Juries has uncovered problems in the current system. Except in a few departments which have implemented or are implementing new systems, accountability for equipment and supplies is weak;

the information systems are deficient; ongoing control and optimization of inventory levels are not primary objectives; there are recurrent losses.

Major features of the current system and the current issues are summarized in the following paragraphs.

Equipment. Each department is accountable for the equipment the County authorizes it to purchase. State and County policy require a triannual physical inventory of all fixed assets. County policy requires an annual report to the Auditor of any equipment or portable items discovered missing during the year; this requires a physical inventory of portable or easily stolen items at least annually. Items discovered stolen must be reported immediately to the local police and to the Auditor. Triannual reports include documentation of items which have exceeded useful life, items sent to salvage or used for parts, items stolen, and items transferred or missing. Departments sometimes do not report an item lost unless it has been missing in two triannual audits -- that is, for six years. Upon receipt of a departmental loss report, the Auditor relieves the department of accountability for the items, adjusts the central inventory records, and makes the appropriate accounting adjustments. At present most departmental recording and reporting systems are manual, while the Auditor has implemented a new, fully automated system.

In 1975, the Grand Jury found that departments do not generally comply with these minimal accountability standards. In subsequent and current departmental audits, the Audit Division of the Auditor-Controller has reported non-compliance. We have reviewed the theft and loss reports received by the Auditor-Controller since 1977; all indications are that only a handful of departments comply consistently with the procedures.

As we pointed out above, some experts express doubt that the County knows what it owns. We further conclude that the County doesn't know what it has lost. The reason is not that the County has no system or an inoperable system; it is that departmental managers tend to place low priority on compliance.

Supplies. Each department is accountable for the expendable supplies used in performing its functions. The County controls annual consumption levels through the budget process, based on historical standards relating need for supplies to demands for service. The Purchasing Officer controls procurement. The purchasing system provides for discretionary purchasing authority in departments and for scheduled direct delivery of goods needed on a continuous basis. Expenditures for supplies, therefore, can be and are controlled.

The relationship of average stock levels to required consumption is controlled only in those County departments which are operating with or implementing state-of-the-art inventory control systems. Without such controls and some use of stock level and reorder optimization, it is impossible to validate the historical budgetary standards or to establish new standards. The

results of non-compliance in this area include hoarding of critical items, shortages of some items and oversupply of others, excessive emergency purchases or other purchases at less than optimum costs, and susceptibility to pilferage and theft. Those are the conditions found in each department whose inventory control systems have been reviewed in recent years by auditors, consultants, and grand juries.

Facilities. Warehousing and storage of County goods and equipment is highly decentralized and dispersed. General fund departments manage 2.2 million square feet of space formally designated as warehouse; they manage additional space for yards, storage, and incidental or point-of-use storage. Special district departments also operate warehouses and storage facilities.

Because some departmental warehouses are located close to one another, and because the demand for some kinds of items is common to several departments, the Board of Supervisors called for efforts, in the late 1970's, to consolidate warehouse and storage space. In Spring, 1980, the Chief Administrative Office established an interdepartmental committee to determine the feasibility of consolidation and to develop a comprehensive plan for accomplishing consolidation where feasible.

The committee determined that consolidation of warehouse and storage facilities would be feasible only if preceded by the development and enforcement of a comprehensive materials management and control policy throughout the County, supported where necessary by automated inventory control systems. The quantity and variety of single use items, together with the size of the system, obviate complete centralization of control functions and warehousing space.

Operating departments, instead, can optimize stock levels and consumption. Controls can be established by Countywide policy, and sophisticated computer support introduced when cost-effective.

Conclusion. Although they are basic, the County has operable accountability and control systems. The County is also improving those systems. The central issue for Board attention is how to invest in improving the systems in an orderly, cost-effective manner.

The problems are serious enough for Board attention. We have not developed a reliable estimate of losses. The readily available information is inadequate to support such an estimate. We have seen enough, from our review of centralized loss records, audit reports, and interviews to convince us that losses are serious and that there is a consistent absence of sustained priority on materials management and equipment control.

More important, we are convinced of significant opportunities for savings, based on the County's recent achievements with attention to improved systems and controls. For example, the new system at USC Medical Center saved \$1.5 million in the first year and will save on the order of \$600,000 in

each subsequent year. These savings are attributable not only to techniques of stock level and replenishment optimization but also to the high level bureaucratic attention to materials management required in developing such systems.

Improvement Strategies

We believe that weaknesses in the County's control of equipment and supplies should be attributed primarily to departmental non-compliance, and secondarily to the County's financial inability, in recent years, to invest either in vigorous enforcement of current policy or in the development of computerized materials management.

We have identified three strategies for Board action to improve control over materials consumption and security of equipment and supplies. They are:

- enforce compliance with current control policies and procedures;
- complete the systems' planning and development work which the Chief Administrative Officer and other central staff or services departments have initiated;
- undertake design and development of comprehensive new policy featuring a high degree of automation where appropriate.

Each of these strategies would impose a cost on the County. The amount and the potential savings would depend on the details of implementation. Based on past experience, it is realistic to expect that savings will result.

Policy Enforcement. The County has systems featuring two control functions over fixed assets and over the stocking and consumption of supplies: the Auditor-Controller's fixed asset accounting and the Chief Administrative Office's budgeting process. We believe that strengthening the level of departmental compliance with these controls would be beneficial.

Complying with current policy requirements involves costs, including labor costs. Departments need staff to conduct physical inventories; the Auditor-Controller needs staff to reconcile financial with physical records and to keep records up to date; the Chief Administrative Office needs staff to develop standards and monitor expenditure levels for compliance with budget decisions. Staffing dedicated to such functions, even for a brief period, is not available for routine or mandatory work. When necessary, County departments have incurred overtime or contract costs to accomplish them -- distasteful options in a period of declining resources. More typically, the materials functions get little attention or are relegated to low levels of departmental organization. Managers have few incentives to incur inventory control costs at the expense of operations and mandatory functions.

Nevertheless, such costs are necessary for materials management, regardless of whether the supporting information systems are highly automated. The central issue is managerial attention. Therefore, we believe that it is reasonable to reaffirm Board direction that all departments comply with the County's current system of inventory control and fixed-asset management.

Planning Project. In 1980, the Chief Administrative Office made substantial progress in identifying Countywide materials management problems, establishing criteria for new systems, and sketching the issues to be resolved in a Countywide policy. The Chief Administrative Office's staff and committee representatives from other key departments addressed the broad range of relevant questions: bureaucratic organization, information systems requirements, standardization, personnel and employee relations, risk management, facilities consolidation, procurement, distribution, and financial management.

The Chief Administrative Office has insufficient resources to sustain high priority effort on this program because of the need to focus the attention of available staff resources on more urgent Board requested projects. As we noted above, the County's experience with systems development has been extremely favorable in those departments which have or are implementing sound systems -- Purchasing and Stores, Sheriff, Department of Public Social Services the USC Medical Center and other hospitals. Therefore, we believe that the Board should ask the Chief Administrative Office to continue this effort and determine the feasibility of alternative designs and policies. The cost would be either in Chief Administrative Office staff time or in contract staff or both.

System Development. County experience with high automated systems for inventory control and material management has been favorable. In all cases, control over loss has been vastly improved, stock levels have been reduced to optimal levels, and replenishment schedules operate at minimum cost.

Because of this experience, it is intuitively appealing to consider development of a comprehensive, fully integrated County-wide materials management system. However, such systems are cost-effective only when justified by the needs of the operating departments, based on quantity and variety of inventory items as well as decentralization of end-user requirements. Other departments could well benefit from smaller, less sophisticated systems, and the needs of some departments may be manageable with manual systems under improved organizational control. Finally, the central issue -- managerial attention to the materials management function -- will not be resolved by new systems. Without improved bureaucratic controls at the department level, the new systems would have few substantial results. Therefore, we believe that Board direction to comply with current systems and a renewal of Chief Administrative Office program planning effort should precede any commitment to investment in large-scale, County-wide information systems development.