
**Thomas P. DiNapoli
COMPTROLLER**



Audit Objective..... 2

Audit Results - Summary..... 2

Background..... 2

**Audit Findings and
Recommendations..... 3**

Recommendations 6

Audit Scope and Methodology..... 6

Authority 7

Reporting Requirements..... 7

Contributors to the Report 7

Appendix A - Auditee Response 8

**Appendix B - State Comptroller
Comments on Auditee
Response 13**

**OFFICE OF THE
NEW YORK STATE COMPTROLLER**

**DIVISION OF STATE
GOVERNMENT ACCOUNTABILITY**

**NEW YORK CITY
DEPARTMENT OF
CITYWIDE
ADMINISTRATIVE
SERVICES - DIVISION OF
MUNICIPAL SUPPLY
SERVICES**

**CENTRAL STOREHOUSE
INVENTORY**

Report 2007-N-1

AUDIT OBJECTIVE

The objective of our audit was to determine whether the New York City Department of Citywide Administrative Services (DCAS) - Division of Municipal Supply Services (DMSS) established and implemented a proper system of control over Central Storehouse inventories.

AUDIT RESULTS - SUMMARY

The Central Storehouse, a 300,000 square foot facility located in the borough of Queens, maintains an inventory of more than 2,200 products. DMSS is responsible for purchasing, stocking and distributing items that are ordered by New York City (City) agencies. We found that DMSS did not establish and implement a proper system of control over these inventories.

We found that DMSS uses Central Storehouse staff to conduct inventory reconciliations and has not provided for an independent audit of the major inventory functions. Independent audits are essential to identifying internal control deficiencies.

Staff responsible for taking physical counts of the items on hand should not have prior knowledge of the amount that is supposed to be in stock. For the fiscal year ended June 30, 2006, inventory counts were taken by staff who had printouts showing the expected quantities on hand.

Duties relating to key inventory functions at the Central Storehouse were not adequately separated to prevent certain employees from having too much control over the reconciliation of Central Storehouse inventory records and the investigation of discrepancies. In general, senior management needs to be kept better informed of inventory discrepancies and inventory adjustments, and

the resulting investigations need to be more closely monitored.

It is important that inventory discrepancies, particularly high-value ones, be properly investigated, and that the investigations are documented. We selected the six highest-value adjustments to the inventory records for the fiscal year ended June 30, 2006. DMSS could not provide documentation showing that three of these adjustments were investigated. These unexplained adjustments include two overages (\$4,731 and \$3,033) and a shortage of \$4,536. In addition, corrective action should be taken to address the cause of major discrepancies.

As our audit progressed and we informed DMSS officials of the weaknesses we identified, they were proactive in addressing many of our concerns. However, DMSS needs to make additional improvements and to ensure that the newly-instituted policies and procedures are functioning as intended.

Our report contains three recommendations to strengthen controls at the Central Storehouse. DCAS officials generally agreed with the recommendations and indicated the actions they have taken, or will be taking to implement them.

This report, dated March 4, 2008, is available on our website: <http://www.osc.state.ny.us>. Add or update your mailing list address by contacting us at: (518) 474-3271 or Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
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BACKGROUND

The New York City Department of Citywide Administrative Services was established in 1996 by the merger of the former departments

of General Services and Personnel. DCAS' primary responsibility is to ensure that other City agencies have the critical resources and support they need. To assist other City agencies, DCAS purchases, inspects, and distributes supplies; provides overall facilities management, including security, maintenance, and construction services; locates space for City agencies; recruits and hires City employees; and administers civil service and licensing services. DCAS is organized into five main divisions, and has 1,700 employees. DMSS is one of these divisions.

One of DMSS' primary functions is managing the Central Storehouse, a 300,000 square foot facility located in Queens. The Central Storehouse has 48 employees, who are responsible for purchasing, stocking, and distributing items that are ordered by City agencies. The Central Storehouse maintains an inventory of more than 2,200 products. If a particular item is carried by the Central Storehouse, City agencies are required to purchase that item through the Central Storehouse.

In the fiscal year ended June 30, 2006, the Central Storehouse purchased \$21.9 million of inventory for redistribution to 80 agencies. For the same period, the Central Storehouse reported that it serviced more than 9,100 requisitions, delivering items to 3,566 individual locations. As of June 30, 2006, Central Storehouse records report an ending inventory valued at \$11.4 million.

AUDIT FINDINGS AND RECOMMENDATIONS

The New York City Department of Investigation (DOI), which performs investigations relating to fraud, corruption, and unethical conduct in City government, has established Standards for Inventory

Control and Management (Standards). The Standards require that City agencies provide for an annual, unannounced audit of their major inventory functions by an independent internal or external audit group according to generally accepted auditing standards. Independent audits are essential to identifying internal control deficiencies that create opportunities for dishonest activity. The Standards further state that audits supplement, but do not replace, ongoing management and supervisory monitoring to detect errors and irregularities that require correction. In this regard, DOI also recommends the following:

- Inventory items should be physically counted by staff that do not have prior knowledge of how many items are supposed to be in stock (i.e., "blind counted").
- A count of all stored goods should be conducted at least once a year to ensure the accuracy of the perpetual records.
- Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.
- Records should be updated to reflect the results of physical counts, and discrepancies should be investigated.
- Transactions should be clearly documented, and the documentation should be readily available for examination.
- Results of oversight and monitoring should be reported to management.
- Corrective action plans should be established to address identified weaknesses.

We found that DMSS did not conform to the Standards. DMSS had not established adequate policies and procedures for controlling inventory, and many of the practices recommended by DOI were not being followed. Importantly, DMSS did not provide for the audit of the Central Storehouse by an independent or external group. Also, for the most recently completed fiscal year (i.e., as of the time of our audit), which ended June 30, 2006, DMSS did not count and reconcile all goods stored in the Central Storehouse.

DMSS' practice was to take periodic physical inventories (referred to as "cycle counts") of selected items on hand at the Central Storehouse. These cycle counts were conducted by Central Storehouse employees who had prior knowledge of the amounts that were supposed to be in stock; in fact, they were provided printouts that showed the expected quantities on hand. Blind counts provide greater assurance that staff will take the time to accurately count the actual number of items on hand.

We also determined that duties relating to key inventory functions were not adequately separated. The same individuals (Storehouse Directors) responsible for selecting items to be counted also had access to the inventory stock. They also were responsible for reviewing discrepancies identified during cycle counts, and for adjusting the inventory based on that review. There was no dollar limit on the amount the Storehouse Directors could adjust.

While DMSS officials agree that the Storehouse Directors select the inventory items to be counted, they explained that the selection is based on a number of factors, including a shortage of an item that should be available. DMSS officials also pointed out that the Storehouse Directors do not work

directly with the stock on the floor on a day-to-day basis. However, based on our observations, Storehouse Directors have easy access to stock on the floor, and therefore can have unchecked access to both the inventory records, as well as the actual inventory stock. We concluded that DMSS needed to strengthen its policies and practices to provide separation over key duties as well as provide independent oversight.

The resolution of discrepancies identified by the physical inventory count should be adequately documented, and this documentation should be available for review. To determine whether inventory adjustments were adequately supported, we requested a reporting of all inventory adjustments for the year ended June 30, 2006.

On March 24, 2007, DMSS officials provided us with a report of 2006 report variances. After reviewing it, we requested documentation supporting the seven highest-value adjustments. However, DMSS officials stated that this report was inaccurate and subsequently, on April 4, 2007, provided a revised version. DMSS officials stated that the report was revised after they noticed data entry errors. They said they had performed an extensive review of the original report, and had made necessary changes based on the results of the cycle counts completed for the fiscal year ended June 30, 2006. We found that four of the seven highest-value adjustments for which we initially had requested documentation, were now listed as having "zero" adjustments. These items (and their original adjustments) included: polyethylene liners (-\$20,543); valves (-\$17,100); bolts (+\$3,618), and wooden step ladders (+\$5,176).

The revised variance report provided to us on April 4, 2007 showed 419 adjustments totaling \$96,613 in which the physical count

exceeded the book count (positive adjustments) and 411 adjustments totaling \$92,208 in which the book count exceeded the physical count (negative adjustments). Some of the adjustments were material, including 42 (22 positive and 20 negative) that exceeded \$1,000 each.

To test the accuracy of the revised variance report, we requested documentation for the six highest-value adjustments (three of these were also included in our original request of seven transactions previously cited). While DMSS officials provided documentation of the actual physical count for all six adjustments, they could provide support for the investigation of just three. This documentation consisted of reconciliation reports that explained the cause of the discrepancies. DMSS officials indicate that investigations were conducted for the other three transactions, but the discrepancies could not be resolved and the inventory record was merely adjusted to reflect the amount on hand. These unexplained adjustments included two inventory overages (\$4,731 and \$3,033) and a shortage of \$4,536.

To test the accuracy of DMSS inventory records, on April 2, 2007, we reconciled the quantities of five high-dollar items on hand at the Central Storehouse with the recorded inventory. Sampled items included large numbers of vacuum cleaners, fans, electric blankets, lamps, and cans of paint. We found that the quantities on hand of four of the five items had been accurately recorded, with only minor discrepancies for the fifth item.

As our audit progressed and as we informed DMSS officials of the weaknesses we identified, DMSS officials were proactive in addressing many of our concerns. Specifically, they instituted a number of new policies and procedures directed at strengthening internal controls at the Central

Storehouse. For the fiscal year ended June 30, 2007, DMSS completed a physical inventory of all goods at the Central Storehouse. New policies and procedures requiring that the inventory be blind-counted were adopted. We observed that, in fact, staff are now performing blind counts.

DMSS also revised its policies and procedures by requiring that discrepancies of \$1,000 or more that remain unresolved after an investigation be reported to the Assistant Commissioner of Materials Management and to the Deputy Commissioner of Municipal Supply Services. However, this procedure should be further strengthened because the Storehouse Directors still decide whether a discrepancy has been properly resolved. Management oversight is needed to ensure the Storehouse Directors are properly resolving and reporting discrepancies. This could involve, for example, spot checks by management independent of the inventory process. In addition, all discrepancies over \$1,000 should be reported to senior management, not just the unresolved ones. This will provide better accountability regarding the resolution of discrepancies.

We were not able to test the implementation of all of DMSS' new policies and procedures since they were being implemented as our audit field work was nearing completion. Therefore, it is critical that DMSS periodically test compliance with the newly-instituted policies and procedures. Also, certain weaknesses identified by our audit remain uncorrected. Importantly, although DMSS officials told us it is their intention to conduct an annual count of the complete inventory, this requirement is not reflected in their written policies and procedures. If an annual count of the complete inventory is not conducted, someone independent of the inventory process should select the items to be counted. Further, DMSS has not provided

for the periodic audit of the Central Storehouse by an independent or external group. DMSS officials indicated that they would consider providing for such audits, subject to the identification of resources.

Recommendations

1. Provide for the periodic audit of the Central Storehouse by an independent or external group.
2. Test newly-instituted policies and procedures periodically to determine compliance.
3. Strengthen policies and procedures as follows:
 - If cycle counts are not done for 100 percent of the inventory stock, have someone independent of the inventory process select the items to be tested.
 - Require that reconciliation reports be kept on file for review.
 - Report all discrepancies greater than \$1,000 (not just those that are unresolved) to the Assistant Commissioner and Deputy Commissioner.
 - Provide for an independent check to ensure that the Storehouse Directors are investigating and reporting discrepancies properly in accordance with policies and procedures.
 - Analyze the types of errors that occur, and implement corrective action to prevent them in the future.

AUDIT SCOPE AND METHODOLOGY

We conducted our performance audit in accordance with generally accepted government auditing standards. We audited selected inventory controls at the Central Storehouse for the period July 1, 2005 through April 30, 2007. To accomplish our objectives, we reviewed Central Storehouse policies and procedures, and interviewed DMSS officials to obtain an understanding of their inventory control policies and procedures. We observed the performance of DMSS cycle counts, and compared the physical inventory with the recorded amounts for sampled inventory items. We also reviewed the variance reports for the 2006 and 2007 fiscal years, as well as selected reconciliation reports and supporting documentation.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

As is our practice, we notified DCAS officials at the outset of the audit that we would request a representation letter in which agency management provides assurances, to the best of their knowledge, concerning the

relevance, accuracy, and competence of the evidence provided to the auditors during the course of the audit. The representation letter is intended to confirm oral presentations made to the auditors and to reduce the likelihood of misunderstandings. Agency officials normally use the representation letter to assert that, to the best of their knowledge, all relevant financial and programmatic records and related data have been provided to the auditors. They affirm either that the agency has complied with all laws, rules, and regulations applicable to its operations that would have a significant effect on the operating practices being audited, or that any exceptions have been disclosed to the auditors. However, officials at the New York City Mayor's Office of Operations have informed us that, as a matter of policy, mayoral agency officials do not provide representation letters in connection with our audits. As a result, we lack assurance from DMSS officials that all relevant information was provided to us during the audit.

AUTHORITY

The audit was performed pursuant to the State Comptroller's authority as set forth in Article

V, Section 1, of the State Constitution; and Article III of the General Municipal Law.

REPORTING REQUIREMENTS

Draft copies of the matters contained in this report were provided to DCAS officials for their review and comment. Their comments were considered in preparing this report, and are included as Appendix A. Appendix B contains State Comptroller's Comments which address matters contained in DCAS' response.

Within 90 days after final release of this report, we request that the Commissioner of the New York City Department of Citywide Administrative Services report to the State Comptroller, advising what steps were taken to implement the recommendations contained herein, and where recommendations were not implemented the reasons therefor.

CONTRIBUTORS TO THE REPORT

Major contributors to this report include Frank Houston, Cindi Frieder, Myron Goldmeer, Altagracia Rodriguez, Katrina Lau, Margarita Ledezma, and Paul Bachman.

APPENDIX A - AUDITEE RESPONSE



DEPARTMENT OF CITYWIDE ADMINISTRATIVE SERVICES
OFFICE OF THE COMMISSIONER

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Martha K. Hirst
Commissioner

January 25, 2008

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Ms. Cindi Frieder
Audit Manager
Office of the State Comptroller
Division of State Government Accountability
123 William Street, 21st Floor
New York, NY 10038

Re: Audit of New York City
Department of Citywide
Administrative Services – Division
of Municipal Supply Services
Central Storehouse Inventory
(2007-N-1)

Dear Ms. Frieder:

Thank you for the opportunity to respond to the Audit of New York City Department of Citywide Administrative Services – Division of Municipal Supply Services Central Storehouse Inventory (2007-N-1).

The Central Storehouse plays a vital role in supporting the operations of New York City agencies. We believe that the effective and proactive management of this operation has resulted in continuing improvements and noteworthy accomplishments over the past ten years. For example, during this period, the Division of Municipal Supply Services (DMSS) analyzed and contracted for the direct-delivery of approximately 500 agency commodities, thereby eliminating the need to carry these items as Storehouse products. This, in turn, freed up space in the Storehouse, allowing for the consolidation and closure of multiple client agency warehouses, and thereby eliminating the duplicate costs associated with space rental, purchase, management, and storage of many similar items.

During this period of time, the Storehouse also assumed an important role in the City's overall emergency planning and response efforts, including holding a lead role in citywide planning for a major coastal storm event. The Storehouse also regularly provides urgent supplies to emergencies including the 2006 blackout in Queens, the 2007 Con Edison steam explosion, hurricanes outside of New York City in areas such as New Orleans and Haiti, and floods in upstate New York. The Storehouse also stores emergency supplies for the Office of Emergency Management and the Department of Health and Mental Hygiene.

Finally, in order to be more responsive to our client agencies, the Storehouse eliminated its former practice of shutting down, often for several weeks, to conduct product inventories and reconciliations. Instead, since 2002 the Storehouse has instituted the practice of “cycle-counting” inventory, which allows for continued operations and enables it to deliver necessary goods to client agencies. It is this inventory process on which the auditors focus in this Audit Report.

Before we comment on the specifics of this Report, we will address the favorable aspects of the Audit. This review covered the warehousing and inventory control practices of the Storehouse. In performing this Audit, the auditors examined the full range of Storehouse operations, including ordering, picking of goods to fill orders, checking of those orders, staging, truck loading, and security functions. They also examined the inspection and acceptance process for incoming orders, delinquent orders, back-ordered items, small-purchase items, and the ten (10) fastest and slowest moving items. The auditors checked for evidence of aged or expired goods, and surveyed a sample of client agencies regarding their satisfaction with the Storehouse services. The auditors spent nearly five (5) months on site performing this work. Significantly, at the conclusion of these reviews, the auditors have reported no findings relative to any of these areas.

Instead, the findings in this Report focus almost entirely on the inventory process. At the conclusion of this document, we will specifically address the recommendations made in the Report. Before then, however, we wish to discuss our concerns with regard to the two areas which were the focus of the findings, specifically: 1) Storehouse procedures identified as needing to be more specific in order to reflect actual cycle counting practices; and 2) the fundamental misinterpretations about Storehouse management, including management data and reporting.

Preliminarily, it bears noting that during the course of this Audit, Storehouse management agreed that cycle counting and reconciliation procedures could be improved and, consequently, have already revised the cycle counting and reconciliation procedures. We believe that these revised procedures address all of the auditors’ concerns and have prepared a separate document that references the specific auditor comments in this Audit Report to various sections of the procedures. This document is available for auditor examination.

There are still, however, some misconceptions concerning information provided to the auditors which we would like to clarify. On page four (4) of the Audit Report the auditors state that “DMSS captures the result of cycle counts on a variance report, which is compiled annually.” This is not correct, as the spreadsheet – or variance report - in question was prepared specially for the auditors from actual cycle count documentation. In addition, this spreadsheet – variance report - initially contained a data entry error which omitted one line of data that resulted in mismatching rows in the spreadsheet and produced incorrect variance amounts. Although a corrected spreadsheet was issued to the auditors when this was discovered, and even though the source documentation supports the values in the corrected spreadsheet, the Audit Report continues to refer to the incorrect variance amounts from the initial variance report. We would ask that this be corrected in the Audit Report.

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Comment
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The Audit Report also raises the issue of separation of duties and states, “[w]e also determined that duties relating to key inventory functions were not adequately separated. The same individuals (Storehouse Directors) responsible for selecting items to be counted also had access to inventory stock. They also were responsible for reviewing discrepancies identified during cycle counts, and for adjusting the inventory based on that review.” This is an incorrect

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Comment
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statement, as addressed in the next paragraph. The Report also recommends, “[i]f cycle counts are not done for 100% of the inventory stock, have someone independent of the inventory process select the items to be tested.”

The Storehouse Directors do not review and reconcile discrepancies; this is done by the Storehouse administrative staff. The Audit Report maintains that the Storehouse Directors should be disqualified from an administrative role in the inventory process by virtue of being located in the office area at the Storehouse, which is located one floor above the goods storage area. We do not agree that this is a valid separation of duties issue. The concept of Separation of Duties can be defined as the practice of dividing the steps in a system function among different individuals, so as to keep a single individual from subverting the process. Physical location or access to a location is not an aspect of separation of duties controls. Additionally, we want to emphasize the following regarding separation of duties at the Storehouse:

- The Storehouse administrative employees do not handle the stock and are independent of the inventory counting operations. These Storehouse administrative employees are also located in the office area of the Storehouse and are tasked with reconciling material inventory variances. We believe that they appropriately hold an important role in establishing separation of duties in the inventory process. Furthermore, all ordering, purchasing, picking, and shipping records, which are necessary for reconciling inventory variances, are located in the administrative area at the Storehouse as well.
- The inventory process cannot be performed without utilizing people who can accurately identify the various items in the Storehouse. Separation of duties in the counting process is accomplished by integrating employees who are independent of the day-to-day operations of the Storehouse into the checking process. For the three major inventory counts (bin, shelf, and floor), other Division of Municipal Supply Services employees complement the Storehouse staff and serve as checkers of the initial count.

We would also like the readers of this report to understand that the Storehouse carries a large number of similar items (for example clear, blue, and black plastic bags, different sizes and colors of paper, etc.) which, whether through picking errors or to address backorder situations, could result in different, yet similar, substitute items being sent to the client agencies. If these situations are not identified at the point of substitution or delivery and the corresponding inventories are not updated, it will result in offsetting a positive inventory variance in one similar item and a negative inventory variance in the other.

It should be noted that out of a total throughput of more than \$21 million in Fiscal Year 2006, the result of all of the cycle counts was a net positive variance of \$4,405. There were 419 commodities with positive variances totaling \$96,613, an average variance of \$230.58 per commodity. This was offset by 411 commodities with negative variances totaling (\$92,208), an average of (\$224.35) per commodity. There were 658 commodities with zero variances. On the basis of the detailed reconciliations that were performed for the variances that exceeded \$1,000, we found that many of these positive and negative variances are the result of the substitution of similar goods in agency orders, which were not identified at the time of the order processing and delivery. For that reason, when considering these very low variance amounts, it is important to consider that these amounts overstate the overages and shortfalls for the inventory.

Recommendations

Recommendation 1: Provide for the periodic audit of the Central Storehouse by an independent or external group.

Response: Agree. We will work to identify necessary resources to perform an independent review.

Recommendation 2: Test newly-instituted policies and procedures periodically to determine compliance.

Response: Agrée. The revised Storehouse procedures address this issue. Section 2.9 details the periodic review of policy and procedures.

Recommendation 3: Strengthen policies and procedures as follows:

- If cycle counts are not done for 100% of the inventory stock, have someone independent of the inventory process select the items to be tested.

Response: The current plan provides for three inventory cycles each year; floor, bin, and shelves, covering 100% of the inventory. We do not believe that it is desirable to plan for less than 100% coverage.

- Require that reconciliation reports be kept on file for review.

Response: Agree. The revised Storehouse procedures address this issue. Section 2.5, point number 15 details that the Cycle Count Reconciliation Report will be kept on file.

- Report all discrepancies greater than \$1,000 (not just those that are unresolved) to the Assistant Commissioner and Deputy Commissioner.

Response: Agree. The revised Storehouse procedures address this issue. Section 2.5 directs that a final inventory variance report will be given to the Storehouse Directors, the Assistant Commissioner, and the Deputy Commissioner.

- Provide for an independent check to ensure that the Storehouse Directors are investigating and reporting discrepancies properly in accordance with policies and procedures.

Response: Agree. Please note that the Storehouse Directors are not tasked with this responsibility, rather it belongs to the administrative staff at the Storehouse. In order to get an *independent* check, however, it will become part of our Independent review referred to in Recommendation 1.

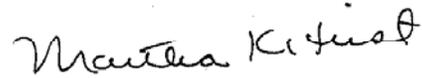
- Analyze the types of errors that occur and implement corrective action to prevent them in the future.

- 5 -

Response: Agree. The revised Storehouse procedures address this issue. Section 2.5, point numbers 4 and 5 cover this recommendation.

We would like to thank the auditors for their work on this Audit.

Sincerely,



Martha K. Hirst

APPENDIX B - STATE COMPTROLLER COMMENTS ON AUDITEE RESPONSE

1. Reference to the variance report being prepared annually has been deleted from the report. This was the document provided when our auditors requested a list of all inventory count variances for the year. Regardless of the reporting format used, the system should be able to provide accurate reporting of inventory variances. Moreover, based on our comparison of the two reports, it does not appear that the differences we identified are the result of mismatched rows caused by the omission of one line of data, as DCAS now asserts. DMSS' written response to this finding at the time of the audit stated that the differences were the result of data entry errors, which were "corrected by reviewing each of the 1486 cycle count sheets and comparing them to what was on each line of the variance report. Once all of the cycle count sheets were verified or corrected against the variance report, the new report was issued..." This explanation is more consistent with our conclusion.
2. As our audit progressed and we informed DMSS officials of the weaknesses we had identified, they revised their inventory policies and procedures to strengthen controls. At the time of the audit, these officials provided us with written responses regarding the accuracy of statements in the report. They confirmed to us that "Discrepancies are reviewed by the Storehouse Directors..." and that the Storehouse Director "...who picks the sample...is authorize[d] to enter the adjustments..." Notwithstanding that different procedures and levels of authority existed at various times during the audit period, DCAS has agreed to implement each of our audit recommendations. This step will strengthen the internal controls structure.