

APPENDIX 1

**City Stores:
Maximize Operating Capacity
to Be More Efficient**

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Auditor General's Office

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EXECUTIVE SUMMARY

***Materials
Management
Stores and
Distribution Unit***

The Materials Management Stores and Distribution Unit in the Purchasing & Materials Management Division (PMMD) manages the acquisition, storage and distribution of corporate materials. The unit uses City facilities to operate City stores and provides leadership and support to four other divisions which operate their own stores.

***2011 budget for
Stores Unit was
\$3.26 million***

The approved gross operating budget for Materials Management Stores and Distribution Unit in 2011 was \$3.26 million with a complement of 31 staff.

The total value of all materials issued from City stores in 2011 was approximately \$6.16 million. PMMD provides administrative support to other City Divisions operating their own divisional stores that issued \$7.28 million in materials in 2011. The unit is also responsible for the storage of approximately \$9 million of pandemic supplies for the City Manager.

Audit Objective

The objective of this audit is to determine if the current stores are being fully utilized and providing cost-effective services.

PMMD currently operates four stores. The main store known as Brant is located downtown. A second store is located at City Hall and the remaining two stores, Bering and Ellesmere, operate in the west and east areas of the City.

***Majority of orders
from Brant store
are delivered while
for Bering and
Ellesmere they are
picked up***

We found distinct differences in the way the main store operates relative to the satellite stores. The main store delivers the majority (75 per cent) of orders received while more than 90 per cent of orders at Bering and Ellesmere are picked up.

Over the years the Bering store in the west and the Ellesmere store in the east have been experiencing a decline in the value of goods being issued. In addition, almost half of the material issued from each of these stores is for two divisions which also maintain their own stores.

Labour costs range from 22 to 74 cents for every dollar issued

The City's labour costs associated with receiving, storing and issuing materials for each store ranged from an additional 22 to 74 cents for every dollar of material issued. There are opportunities to further rationalize City stores in order to achieve operating efficiencies.

No corporate directive to use City stores

City stores obtain the best price from competitive bids however there is no corporate directive for City business units to order from the stores. There are significant opportunities for the City to achieve savings from improving coordination of purchasing functions. The Toronto Community Housing Corporation recently reported an estimated annual cost savings of \$5 to \$7 million from increasing coordination of the procurement function with the City.

Optimum performance from technology

There are other opportunities to increase the efficiency of stores' operations through modernization. Divisions currently use a paper based system to order goods from stores. Updating this to an on-line order entry system would be more efficient. Likewise, tracking the movement of goods is done through manual data entry. Systems are readily available to significantly automate these transactions. These systems do come at a cost that should be assessed to ensure any change would result in a net benefit to the City.

Status report to Council on Yard Consolidation Study needed

Many City stores are located in yards and any consideration of rationalizing stores must also consider the opportunity costs associated with City yard operations. At the time of this audit the Yard Consolidation Study was completed for only one district. A status report to Council on this matter is outstanding and needs to be provided.

Conclusion

In summary, there are opportunities to modernize and further rationalize all of the City's stores' operations in order to maximize operating capacity and become more efficient.

BACKGROUND

Materials Management Stores & Distribution Unit

The Materials Management Stores and Distribution Unit in the Purchasing and Materials Management Division (PMMD) manage the acquisition, storage and distribution of corporate materials. PMMD uses City facilities to operate City stores. The goods in City stores are purchased primarily by City divisions.

Common information system to better manage corporate inventories

The corporate materials management model includes the use of a common information system for managing and controlling inventories, development of materials management policies and procedures and the use of performance indicators and metrics. PMMD provides leadership and support to other City divisions that need to maintain specialized materials to ensure continuity of their operations.

PMMD manages approximately \$9 million of pandemic supplies for the City Manager and supports separate stores operated by Divisions with annual materials issuance in the range of \$7 million.

Four Divisions in the City have their own stores

The following four Divisions maintain their own stores and receive a certain level of support from PMMD:

- Emergency Medical Services
- Fire Services
- Water Services
- Parks, Forestry and Recreation

Each of these divisions is responsible for performing their own inventory control functions. In addition Transportation Services maintains a warehouse for division specific materials and is currently working with PMMD to rationalize this space.

Table I provides an overview of the major City stores operated during 2011.

*Summary of
stores operations*

Table I: 2011 Inventory and Value of Goods Issued

Division	Number of Stores	Inventory Value \$(‘000)	Value of Goods Issued \$(‘000)	Number of Distinct Items Stored
Purchasing & Materials Management	6	\$1,367	\$6,159	2,236
Emergency Medical Services	1	1,432	2,894	493
Parks, Forestry & Recreation	1	139	643	435
Fire Services	1	1,014	1,545	521
Toronto Water	6	1,434	2,200	2,127
Total	15	\$ 5,386	\$ 13,441	5,812

2 of the PMMD stores were closed towards the end of 2011

All products available at City stores are listed in a catalogue available on the City’s intranet and may either be picked up or delivered. When materials are issued from the stores they are expensed to the cost centres specified by the division. While there are common materials available in the City stores the divisional stores for the most part maintain products unique to their operation. For example, firefighter boots and other apparel or uniform items are only available from Fire Services own store.

*31 staff and a
2011 gross
operating budget
of \$3.26*

For 2011, the approved complement for the PMMD Stores Unit was 31 full time staff. These staff are responsible for ordering, receiving, distribution and control of materials maintained in City stores and providing support to divisions who operate their own dedicated stores. The approved gross operating budget for the unit in 2011 was approximately \$3.26 million.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

The Auditor General’s annual Work Plan included a review of storage warehouses optimization.

The objective of this audit is to determine if the current stores are being fully utilized and providing cost-effective services.

The scope of this review was restricted to stores and warehouses run by PMMD’s Materials Management Stores and Distribution unit. This review did not include any detailed review of stores operated by other City divisions, agencies or corporations. This audit covered the period January 1, 2010 to December 31, 2011.

Our audit methodology included the following:

- review of corporate policies and procedures
- researched relevant Council and committee reports
- interviews with City staff
- site visits to City stores
- analysis of materials issued by each City store in 2011
- review of performance metrics for stores operated by PMMD
- tour of a private sector warehouse operation that distributes goods throughout Ontario
- survey of other jurisdictions in Canada and the U.S.

Compliance with generally accepted government auditing standards

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 RESULTS

A. CITY STORE OPERATIONS

A.1. Rationalize Store Operations to Achieve Corporate Efficiencies

\$6.16 million of goods ordered from City stores in 2011

The total value of all materials issued from six City stores was approximately \$6.16 million, in 2011. This value includes \$1.6 million of materials shipped directly from the vendor to the end user. PMMD closed two stores in late 2011 due to declining levels of issuance.

City stores are geographically dispersed

The remaining four City stores are spread geographically throughout the City. There is a major store facility on Brant Street downtown and three satellite locations. These include a small operation out of City Hall and two larger stores with one in the east on Ellesmere Road and the other in the west on Bering Avenue. All four operations are situated on city owned properties.

Human resources at each City store

The stores are open Monday to Friday from 07:00 to 15:30 hours except for City Hall which only operates on Wednesdays. The Brant store has eight staff (including the staff member who attends City Hall once a week) while the other two stores each operate with two staff who receive materials from vendors and process orders from divisions.

Materials are delivered, picked up or shipped direct by vendor

The Brant store has two additional staff who use two trucks to make deliveries across the City. Aside from items that are picked up at the stores, certain vendors also deliver materials directly to the business user. In these cases, called “drop shipments”, the goods do not physically pass through the City store.

Table II lists each of the stores run by PMMD and provides a summary of inventory in each store at the end of 2011 along with the number of orders and the dollar amount issued by each store.

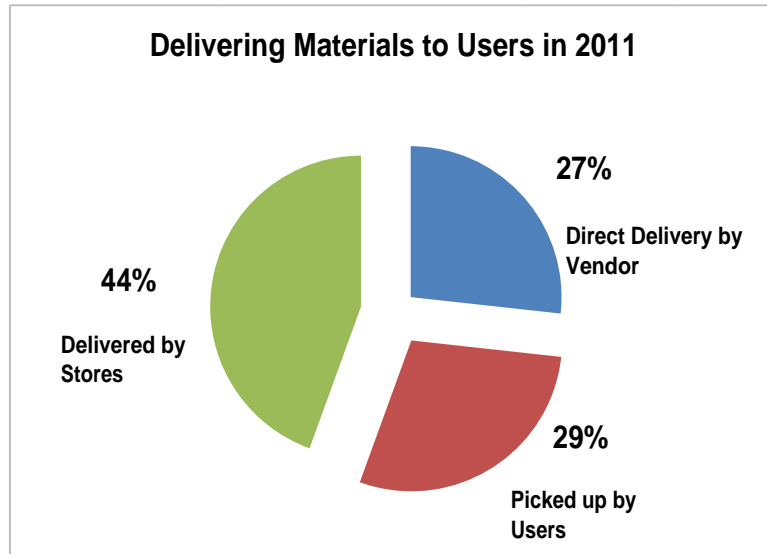
Table II: City Store Operations in 2011

Store	Inventory Value	Potentially Obsolete	Orders Processed	Value Issued	Active Items
Brant	\$ 831,190	\$ 80,200	14,455	\$ 3,385,290	1,151
Bering	\$ 138,430	\$ 25,350	2,297	\$ 444,670	502
Ellesmere	\$ 263,000	\$ 26,010 ¹	1,488	\$ 291,320	439
City Hall	\$ 17,940	\$ 7,620	654	\$ 161,120	12
Drop Shipments	--	--	2,561	\$ 1,644,000	--
Closed Stores					
River	\$ 59,099	\$ 50,222	627	\$ 145,450	34
Finch	\$ 57,370	\$ 30,618	397	\$ 87,450	98
Total	\$ 1,367,029	\$ 220,020	22,479	\$ 6,159,300	2,236

¹Excludes \$133,000 recording error discussed later in this report

Our analysis of materials, (see Figure 1 below), issued by City stores in 2011 found that, for the Brant Store, just under half of all orders were delivered by City staff. The balance of goods were split almost equally between direct deliveries by the vendor and pick ups by the end user. Figure I summarizes this information.

Figure I:



More than 90% of materials from Bering & Ellesmere stores are picked up

More than 90 per cent of the issuances from Ellesmere and Bering stores were picked up, whereas the Brant store only had about a quarter of the issuances picked up.

The Table III below summarizes the purchases made by four main user divisions of the satellite stores.

Satellite stores used by 4 divisions and 2 have divisional stores

Table III: Use of Satellite Stores

User Divisions	Ellesmere Store		Bering Store	
	% of Volume	Value Issued	% of Volume	Value Issued
Transportation	30%	88,425	30%	133,532
*Parks, Forestry & Recreation	29%	84,827	42%	188,540
*Water	16%	45,701	15%	67,798
Solid Waste	16%	46,485	5%	20,296
Other	9%	25,882	8%	34,500
Total	100%	\$ 291,320	100%	\$ 444,666

**Operate stores in their Division*

Two of the main divisions using the City’s satellite stores maintain store operations of their own. We were advised that the store operated by Parks, Forestry, and Recreation staff only serves the south district; however, it does issue clothing to all districts.

The six stores operated by Toronto Water are located in district yards. These stores do not carry the common consumable materials supplied by the City stores but rather carry division specific materials. At the time of this audit, Toronto Water District Operations was working with PMMD to review opportunities to rationalize the store operations in their division.

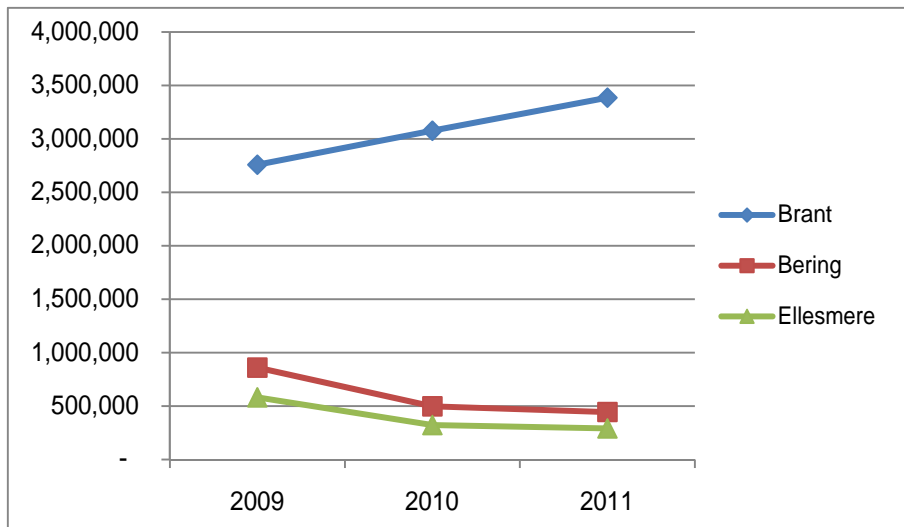
City Hall store is more of a holding area

Although the City Hall location operates as a store on Wednesdays, it is more of a holding area. The store does not have significant issuances and is a convenience for City Hall staff. Given the minor operation of this store, and the convenience for City Hall staff, we did not perform any additional work on this location.

Declining issuances at satellite stores

We reviewed issuances by the three larger stores for the last three years and identified a declining trend for both east and west stores but an increase for the downtown store. Figure II illustrates the issuance pattern for the fiscal years of 2009 to 2011 for each warehouse. In late 2009 all clothing items and toner cartridge supplies were consolidated at the Brant location resulting in significant increases in the Brant store and major drop at the other two stores. Although not as pronounced, the decline in issuances for the two satellite stores continued from 2010 to 2011, while the Brant store continued to show an increase in issuances during that same period.

Figure II: Value of Goods Issued from City Stores – 2009 to 2011



Labour costs range from 22 to 74 cents for every dollar of material issued

We analyzed the City's costs associated with receiving, storing and issuing materials for each store (except City Hall). We found that for every dollar of material issued in 2011 by the Brant store there was an additional labour cost of 22 cents. Similarly, the labour costs at the other stores are an additional 38 cents at Bering and 74 cents at Ellesmere.

In comparing the costs between the three locations, it is relevant to consider that the two satellite locations, with the higher costs, deliver only a small percentage of goods issued. Although operating the satellite stores represents a convenience for the divisions using them, proper planning of supplies requirements could alleviate the need for a separate warehouse and reduce overall costs for stores.

Rationalize stores to achieve efficiencies

PMMD has taken steps to rationalize City store operations by closing two stores in 2011. Given the low activity levels in the two satellite store locations, further rationalization may be possible to achieve additional operational efficiencies. Any decisions related to additional rationalization needs to consider all divisions operating stores and that there may be a potential for increased service demands resulting from any consolidation of purchasing activities with Agencies and Corporations as discussed later in this report.

Recommendation:

- 1. City Council request the City Manager to examine opportunities to further rationalize operations in both City and divisional stores in order to achieve corporate operating efficiencies.**

A.2. Maximize the Use of City Stores

City stores get best price from competitive bids

City stores maintain inventories of commodities required to support operations in various business units across the City. Products available through City stores are bought in large volumes through blanket contracts awarded to suppliers through the City's competitive bidding process. These contracts ensure the best price is obtained for goods purchased.

Materials available in City stores

Although City stores carry over two thousand different products, our analysis of 2011 activity indicates that 20 items accounted for \$3.4 million or 55 per cent of the value of all issuances. These high demand items are listed in Exhibit 1.

No corporate directive for business units to order from the City stores

Despite the corporate bidding process undertaken by the City to obtain the best price for the products identified in Exhibit 1 there is no corporate directive to ensure City divisions, agencies and corporations obtain these materials from the City stores.

Improving coordination of purchasing function can achieve savings

Instead, City divisions and related entities may purchase these products through the use of a purchasing card, divisional purchase order or issue their own calls for these same materials.

This issue has previously been identified and reported by the Auditor General's Office as a common theme where improved coordination or consolidation of certain functions across City entities can result in additional savings and efficiencies.

TCHC saves \$5 to \$7 million from improved coordination with City purchasing

The recent experience of the Toronto Community Housing Corporation is an example to illustrate this point. The Toronto Community Housing Corporation reported an estimated annual cost savings in the range of \$5 to \$7 million, on purchases of \$20 to \$25 million by increasing coordination of procurement operations with the City including the use of stores. Similar initiatives need to be explored with other City agencies and corporations.

Better pricing possible through a City Purchasing Cooperative with agencies and corporations

The City currently has a purchasing and materials management cooperative where the municipal sector is working with the education sector for sourcing certain products.

No similar collective purchasing model is in place between the City and its agencies and corporations. All of these City entities could benefit from pooling their purchasing power with the City in order to get better prices. In addition, any increased demand for materials available from City stores would contribute to operating efficiencies.

Recommendations:

- 2. City Council request the City Manager to direct divisions to use City stores as much as possible for common materials regularly in stock at City stores.**
- 3. City Council request the City Manager, through the Shared Services review, to explore ways to maximize purchasing power and rationalize materials handling for items commonly purchased by the City, its Agencies and Corporations.**

B. ACHIEVING OPTIMUM PERFORMANCE

In an operation such as the City stores where there is no automation the only way to process more orders is to have more staff available. While consolidation of human resources and increased volume can improve operating efficiencies there are certain areas where technology will need to be used to achieve any additional efficiencies. Two areas that we identified that could be modernized with current technology are the system to order goods from stores and the tracking of materials movement. This will become increasingly important if volume levels increase as a result of consolidating more purchasing and distribution activities.

B.1. Paper Based Order System Needs to Be Updated

Orders for materials are faxed by divisions to the stores

All items available at City stores can be found on a list posted on the City's intranet site. Although the list is available online, the ordering of products from City stores is paper based. In many cases orders are written up by the requesting division and then faxed to the store to be processed. When the order is processed at the warehouse it is recorded in the City's financial information system.

Order forms should be in electronic format

The current system for placing orders at the City stores needs to be modernized so that divisions can place orders electronically. There should be no need for completing, and then faxing, a paper based order. Once an order is filled, this would be processed in the system and the inventory records automatically updated saving extensive staff time recording this information from paper based orders.

We were advised by management that such a system has been identified as part of the electronic procurement initiatives. However no implementation plan is in place.

Recommendation:

- 4. City Council request the Director, Purchasing and Materials Management, in consultation with the Chief Information Officer, to develop and implement an online system for ordering goods from City and Divisional stores.**

B.2. Examine Costs of Technology to Track Material Movement

Potential to automate movement of inventory

When goods are received or issued by the City's stores the process is completely manual and paper based. There are opportunities to explore how scanning devices can be used to control the movement of goods in and out of City stores.

Systems can be costly but benefits may exceed costs

Staff indicate that efficiencies may be gained by the use of such technology. To date, no study has been conducted to assess the costs and benefits associated with integrating this technology into existing operations. Such an analysis is required to determine whether such a system can produce savings for the City.

Recommendation:

5. City Council request the Director, Purchasing and Materials Management, in consultation with the Chief Information Officer, to review the costs and benefits associated with integrating scanning technology into existing City and Divisional store operations.

B.3. Leverage Use of Direct Delivery By Vendor

Vendors shipping directly to end users reduces staff material handling efforts

Certain materials can be ordered from vendors with a requirement that the goods be shipped directly to the divisional end user. These are known as drop shipments as the materials do not come through the stores. We were advised that these types of orders are placed at the discretion of staff in the stores and vendors generally require a minimum order level for providing this service.

Increasing use of drop shipments

A review of the use of drop shipments for a three year period found a significant increase of 48 per cent in their use from 2009 to 2010 and a further increase of 8 per cent in 2011.

Leverage use of drop shipments

Our analysis of 14 high volume materials issued in 2011 found four of the items could have been drop shipped but were being picked up or delivered by City staff. For the other ten materials, drop shipments were being used, however there were still numerous instances where the goods were delivered or picked up by City staff. Maximizing the use of drop shipments will reduce the demand on staff in the stores and leave them free to attend to other duties or alternatively to manage any increase in activity levels.

Recommendation:

- 6. City Council request the Director, Purchasing and Materials Management to improve the drop shipment business process and leverage additional opportunities for direct delivery by vendors to end users.**

B.4. Establishing Metrics and Measuring Performance

Corporate materials management model

PMMD has developed and implemented a corporate materials management model focused on improving materials management and inventory control.

Corporate performance metrics established for effective inventory control

As part of the corporate wide materials management strategy PMMD developed four key performance metrics to measure the effectiveness of inventory control. The metrics along with established targets and 2011 performance are summarized below:

Performance Metrics	Target	2011 Actual
Inventory Turnover Rate (times per year)	5 or more	5.9
Inventory Error Rate	5 % or less	4.13 %
Inventory Stock Out Ratio	2.5 % or less	3.54 %
Inventory Distribution Service (business days)	7 or less	4.85

Over the years, PMMD has been working to achieve these targets in the City stores. The division also supports those divisions managing their own inventory to work towards meeting these metrics.

Reported inventory turnover rate of 5.9 for 2011

The inventory turnover rate measures the value of materials issued in a year relative to the average value of inventory maintained in stock. As part of the 2012 Operating Budget submission the division reported 2011 turnover as 5.9 times per year.

We reviewed the inventory turnover rate and in our view the performance is overstated based on how the metric is determined. PMMD includes drop shipments in the turnover rate and given that these goods are not handled by stores staff they should be excluded from the turnover rate.

***Audited metric
for each City
Store***

The reported rate of 5.9 for 2011 was an average for all stores and also included the value of “drop shipments.” When the drop shipments are excluded the average inventory turnover rate is 4.26. We also noted significant differences in the turnover rate for each store:

City Store	Inventory Turnover Rate
Brant – Downtown	4.83
City Hall	10.52
Bering – West	3.41
Ellesmere - East	2.78

In summary, when drop shipments are excluded, only one store meets the turnover rate metric. This indicates a lower than expected activity level at the stores that should improve with the rationalization and consolidation initiatives recommended earlier in this report.

Recommendation:

- 7. City Council request the Director, Purchasing and Materials Management to exclude drop shipments from the calculation of inventory turnover rate.**

C. OTHER ISSUES

C.1. Yards Consolidation Study

***Yard
Consolidation
Study requested
in 2001***

City Council directed the City Manager to undertake a Yards Consolidation study in 2001. The Deputy City Manager and Chief Financial Officer was asked to report back annually on the status of the project.

In 2003 the Auditor General’s Procurement Processes Review included a recommendation pertaining to the rationalization of City stores with a view to consider the opportunity costs of the buildings and land where the City stores were located.

In 2005 the Corporate Warehouse rationalization project recognized that City stores are often located in City yards occupied by other divisions. It was recognized that any opportunities to rationalize land and buildings needed to be considered in conjunction with the Yards Consolidation Study being conducted by the Real Estate Division.

***First phase of
Yards
Consolidation
Study complete***

The first phase of the Yards Consolidation Study, which dealt with the former Etobicoke and York, was completed in June 2009.

Although the Bering Yard was included in the first phase of the Yard Consolidation Study, significant changes have occurred to the site since the initial review was completed. For example, Fleet Services and Toronto Water have vacated this yard, reducing the activity levels at this location. The City store currently operating out of this yard is being considered for consolidation in 2014 with another store location. This would further reduce the activity level in the yard and result in Transportation Services as the sole occupant of this yard. The cumulative effect of these changes warrant a reconsideration of the 2009 decision to maintain this yard.

***Review the
opportunity costs
of current use of
Bering Yard***

A review of the Bering Yard should analyze the opportunity costs of maintaining operations on the site by taking into account the following factors:

- appraised value of the land
- ongoing tax revenues if land were sold
- any resulting impact on service delivery from any redevelopment of the land
- benefits of maintaining the site as a city yard
- ongoing costs to maintain the property as a City yard

***Status report to
Council
outstanding***

Currently the Real Estate Division is in the process of completing the Yards Consolidation Study in the other three districts. A status report to Council on the outcome of the Yards Consolidation Study was outstanding at the time of our review.

Recommendation:

- 8. City Council request the Deputy City Manager and Chief Financial Officer to report to City Council on the status and completion schedule for the Yards Consolidation Study, including a reconsideration of the Bering Yard.**

C.2. Administrative Correction for Obsolete Materials

Our review of the potentially obsolete materials recorded for the Ellesmere store found an unusually high level of such items.

We were advised by management that in 1999, inventory belonging to Toronto Water with a value of approximately \$133,000 was incorrectly input as part of the Ellesmere store inventory.

Although management is aware of this issue the required correction to the financial records has not been made. At the time of our audit PMMD staff had initiated discussions on the accounting entries to be made to correct the error.

Recommendation:

- 9. City Council request the Director, Purchasing and Materials Management to take the appropriate action to correct the 1999 inventory input error in the financial information system for the Ellesmere store location.**

CONCLUSION

This report presents the results of our review of City stores run by the Materials Management Stores and Distribution Unit in Purchasing and Materials Management Division. However, the findings are relevant for all store operations in the City.

Addressing the recommendations in this report will achieve operating efficiencies by maximizing the capacity of City store operations in supplying materials to all City business units, including agencies and corporations. Integrating technology into the City store operations will also help to achieve optimum performance.

This report also recommends a status report be provided to Council on the Yards Consolidation Study and a reconsideration of the opportunity costs of the City's Bering Yard given all the changes to the operations at the site.

EXHIBIT 1**Top 20 Materials Issued by City Stores in 2011**

	Materials	No. of Orders	Total Issuance Amount \$	Amount of Materials Drop Shipped \$	Percent Drop Shipped
1	Toners	2,831	835,550		
2	Photocopy paper*	2,911	630,317	472,208	75%
3	Paper Towels*	2,139	374,077	275,917	74%
4	Toilet Paper*	1,296	299,355	229,575	77%
5	Garbage Bags*	1,667	296,826	165,050	56%
6	Tokens	423	267,039		
7	Gloves	1,571	164,062		
8	Catch Basin*	69	84,864	33,016	39%
9	Rainwear	230	74,771		
10	Salt, rock*	142	53,843	29,240	54%
11	Storage Cases	584	41,355		
12	Traffic Cones*	91	40,951	13,156	32%
13	Facial Tissues*	722	39,884	18,465	46%
14	Folders	83	32,699		
15	Antibacterial Hand Cleaner*	124	29,928	16,168	54%
16	Germicidal Detergent*	233	23,052	7,703	33%
17	High Visibility Clothing	104	22,846		
18	Sunscreen	184	22,348		
19	All Purpose Cleaner*	97	21,020	12,639	60%
20	Safety Glasses	214	20,343		
	Total	15,715	\$3,375,130	\$1,273,137	

Note:

Certain materials contained multiple types and for the purpose of this presentation have been collapsed into one category

* These materials have been directly delivered by vendors