

**OFFICE OF THE CITY CONTROLLER**



**HEALTH AND HUMAN SERVICES DEPARTMENT  
UNANNOUNCED INVENTORY AUDIT**

**Annise D. Parker, City Controller**

**Steve Schoonover, City Auditor**

**Report No. 04-03**



OFFICE OF THE CITY CONTROLLER  
CITY OF HOUSTON  
TEXAS

ANNISE D. PARKER

March 2, 2004

The Honorable Bill White, Mayor  
City of Houston, Texas

SUBJECT: Health and Human Services Department  
Unannounced Inventory Audit (Report No. 04-03)

Dear Mayor White:

The City Controller's Office Audit Division has completed an Unannounced Inventory Audit of the Health and Human Services Department's (Department) pharmaceutical warehouse located at 1116 South Braeswood as of September 8, 2003. The audit objective was to assist management with the assessment of the adequacy of internal controls related to inventory management at the above warehouse location. Additionally, the financial related audit evaluated compliance with departmental standard operating procedures.

The report, attached for your review, concluded that internal controls over physical inventory at the warehouse are not adequate to provide Department management with reasonable assurance that physical inventories are properly safeguarded and managed. Draft copies of the matters contained in the report were provided to appropriate Department officials. The findings and recommendations are presented in the body of the report and the views of responsible officials as to actions being taken are appended to the report as Exhibit I.

Respectfully submitted,

Annise D. Parker  
City Controller

xc: City Council Members  
Michael Moore, Chief of Staff, Mayor's Office  
Anthony Hall, Chief Administrative Officer  
Earl Travis, Acting Director, Health and Human Services Department  
Judy Gray Johnson, Director, Finance and Administration Department

## CONTENTS

LETTER OF TRANSMITTAL .....	i
SCOPE AND PURPOSE .....	1
CONCLUSION .....	1
INTRODUCTION.....	2
AUDIT FINDINGS AND RECOMMENDATIONS	
I. SLOW TURNOVER OF INVENTORY ITEMS.....	3
II. UNANNOUNCED INVENTORY COUNTS.....	4
III. ABSENCE OF WRITTEN POLICIES AND PROCEDURES .....	4
IV. MAXIMUM/MINIMUM REORDERING POINTS NOT ESTABLISHED .....	5
V. NO BIN LABELS ON WAREHOUSE SHELVES .....	5
VI. COMMODITY CODES DID NOT AGREE .....	5
VII. INACCURATE ORDER FORM.....	6
VIEWS OF RESPONSIBLE OFFICIALS - EXHIBIT I	

## SCOPE AND PURPOSE


Our scope consisted of conducting an unannounced inventory count and reviewing inventory management procedures at the Health and Human Services Department's 1116 South Braeswood Warehouse as of September 8, 2003. Our objective was to assist management with the assessment of the adequacy of internal controls related to issuing, recording, safeguarding, and valuing assets. Additionally, the audit evaluated the Department's compliance with its own standard operating procedures.

Departmental management is responsible for establishing and maintaining a system of internal controls to adequately safeguard the physical inventory as an integral part of the Department's overall internal control structure. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and are recorded properly.

Due to the inherent limitations in any system of internal accounting controls, errors or irregularities may occur and not be detected in a timely fashion. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may change.

## CONCLUSION

Based on the results of our audit, we concluded that internal controls over the Health and Human Services Department's inventory warehouse are not adequate to provide Department management with reasonable assurance that physical inventories are properly safeguarded and managed.



Dennis Frazier  
Auditor-in-charge



Kenneth Teer  
Audit Manager



Steve Schoonover  
City Auditor

## **INTRODUCTION**

On September 8, 2003, Controller's Office auditors conducted an unannounced inventory audit of Health and Human Services Department's Warehouse (Central Pharmacy) located at 1116 South Braeswood. The Central Pharmacy supplies medicines and materials to eight health centers which are La Nueva Casa De Amigos Health Center, Lyons Avenue Health Center, Magnolia Health Center, Northside Health Center, Riverside Health Center, Sunnyside Health Center, West End Health Center and Medical Center Clinic.

The value of the inventory on the date of the audit was \$501,102. The turnover analysis in the following table was based on reports dated September 8, 2003.

**AUDIT FINDINGS AND RECOMMENDATIONS**

**I. SLOW TURNOVER OF INVENTORY ITEMS**

**BACKGROUND**

The following table reflects inventory usage at the Health and Human Services warehouse.

**Inventory Usage Analysis Tables**

**HEALTH AND HUMAN SERVICES – WAREHOUSE 042  
 AS OF SEPTEMBER 7, 2003  
 WAREHOUSE 042  
 AS OF SEPTEMBER 7, 2003**

**Inventory Usage Analysis Table**

	<b>No. of Commodities</b>	<b>Usage in \$'s</b>	<b>Value On Hand 9/7/2003</b>	<b>On Hand %</b>	<b>INVENTORY TURNOVER</b>	<b>Supply On Hand In Years</b>
	72	0	33,719	6.73%	0.00	Infinite
	11	2,467	33,476	6.68%	0.07	10 Yrs & Up
	85	161,993	419,666	83.75%	0.39	1 To 9.99 Yrs
<b>Subtotal/ Calculation</b>	<b>168</b>	<b>164,460</b>	<b>486,861</b>	<b>97.16%</b>	<b>0.34</b>	<b>3 Years</b>
	31	76,664	14,241	2.84%	5.38	.01 To .99 Yrs
	1	314	0	0.00%	∞	0 Years
<b>Subtotal/ Calculation</b>	<b>32</b>	<b>76,978</b>	<b>14,241</b>	<b>2.84%</b>	<b>5.41</b>	<b>.19 Years</b>
<b>Total/ Calculation</b>	<b>200</b>	<b>241,438</b>	<b>501,102</b>	<b>100.00%</b>	<b>0.48</b>	<b>2.08 Years</b>

Source: Weekly Warehouses Inventory Status By Part Number Report (ICS102) dated September 7, 2003. We also used the ABC Inventory Control by Warehouse Report (ICS661) for the Quantity Issued Amount Dated August 26, 2003.

**FINDING**

Our analysis of the inventory at warehouse 042 revealed that \$486,861 (97%) of the \$501,102 total inventory on hand, will be in inventory an average of 3 years. Of the \$486,861, \$67,195 of the commodities have a supply greater than 10 years and \$419,666 of the commodities have a supply greater than one but less than 10 years. The remainder, \$14,241 (3%) will be in inventory an average of approximately 2 months.

The cost of acquiring, warehousing, and managing excessive quantities of inventory is an unnecessary commitment of City resources and exposes the inventory to obsolescence and misappropriation.

**RECOMMENDATION**

We recommend that management dispose of excess and obsolete items and draft and adopt Standard Operating Procedures to include a schedule for a periodic review to remove obsolete items from stock.

**II. UNANNOUNCED INVENTORY COUNTS**

**BACKGROUND**

A judgmental sample was selected to perform a physical inventory count from the pharmacy items. The sample consisted of 60 different items and was chosen from the Warehouse Inventory Status or ICS102 Report provided by pharmacy management.

**FINDING**

Our testing revealed significant differences between the perpetual records and the physical inventory counts as follows:

- The “Quantity on Hand” per the Inventory Status Report did not agree to the auditors’ physical inventory count for 95% (57 of 60) of the sample items reviewed.

**RECOMMENDATION**

A cycle count concentrates efforts on the inventory with the highest issue activity value and the highest risk of error. To identify differences between actual inventory quantities and the perpetual records, we recommend that management routinely perform inventory cycle counts. Management should then determine the cause of the differences and take appropriate corrective action.

**III. ABSENCE OF WRITTEN POLICIES AND PROCEDURES**

**FINDING**

The Central Pharmacy does not have in place written policies and procedures detailing how to account for inventory. Absence of procedures may have caused some of the noted issues.

**RECOMMENDATION**

We recommend that the Central Pharmacy immediately develop written policies and procedures to account for inventory and that its staff become trained in record keeping.

#### **IV. MAXIMUM/MINIMUM REORDERING POINTS NOT ESTABLISHED**

**FINDING**

Our review disclosed that the Central Pharmacy has not established the maximum or minimum amounts of medicines that should be on hand.

Establishing a maximum is essential as it will minimize excessive inventory levels exposure to obsolescence and misappropriation.

Establishing the minimum amounts to be on hand is critical as it ensures sufficient quantities are on hand to avoid a shortage of medicines.

**RECOMMENDATION**

We recommend that the Central Pharmacy establish maximum or minimum reordering points to eliminate the excess or shortage of medicines.

#### **V. NO BIN LABELS ON THE WAREHOUSE SHELVES**

**FINDING**

Bin labels help ensure that warehouses remain organized and make it easier to compare the actual inventory quantities to the perpetual records. An inventory bin label was not affixed to the bin location on the Central Pharmacy Warehouse shelves for 44 out of 60 (74%) items that were tested.

**RECOMMENDATION**

We recommend that the Central Pharmacy attach bin labels to the bin locations that do not have a label. The labels should include the part description, commodity code number, unit of measure and bin and row numbers.

#### **VI. COMMODITY CODES DID NOT AGREE**

**FINDING**

The commodity codes at the bin location should correspond to the perpetual records to help maintain inventory control. The commodity codes at the bin location did not agree with the commodity codes of the Warehouse Status Report for 48 of 60 (80%) items that were tested.

**RECOMMENDATION**

We recommend that the Central Pharmacy review and correct the differences between the commodity codes at the bin location and the commodity codes of the Warehouse Status Report.



## **VII. INACCURATE ORDER FORM**

### **FINDING**

Order forms used by the health centers help ensure accurate records. The commodity codes for 6 of 25 (24%) items we tested differed on the order forms from the Warehouse Status Report provided by the City's Strategic Purchasing Division and the Pharmacy's Catalog for 2003 Medication.

### **RECOMMENDATION**

We recommend that the Central Pharmacy revise the order form to reflect the category codes of the Pharmacy's Catalog for 2003 Medication.

# EXHIBIT I



**CITY OF HOUSTON**  
Health and Human Services  
Department

**Interoffice**

Correspondence

To: Annise D. Parker  
City Controller

From: M. desVignes-Kendrick, MD, MPH  
Director

Date: February 12, 2004

Subject: **PHARMACY UNANNOUNCED  
INVENTORY AUDIT DRAFT  
REPORT**

The Houston Department of Health and Human Services (HDHHS) thanks your office for assistance in the evaluation of internal controls over the HDHHS Pharmacy's inventory warehouse. Attached is HDHHS's response to the draft audit report received by my office on January 29, 2004.

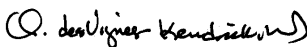
HDHHS's response includes relevant facts related to some of the draft report's findings as provided by Dr. Kate C. Pitts, Chief Pharmacist that, in our opinion, should be reconsidered and result in changes to the wording/conclusion in the following findings.

<b>Finding #1</b>	<b>Slow Turnover of Inventory Items</b>
<b>Finding #3</b>	<b>Absence of Written Policies and Procedures</b>

HDHHS would appreciate your office's response on the findings listed above, prior to the issuance of a final report. Please be assured, HDHHS will work diligently to fully address the findings and recommendation included in the final report.

Your assistance is requested in returning to our previously established practice with the Controller's Office of submitting draft and final audit reports directly to my office for department's responses with a copy of Monir Ibrahim, HDHHS Internal Audit Manager. This practice has assured appropriate and timely responses from HDHHS. Again, HDHHS appreciates the assistance provided by your office.

If you have questions, please contact Mr. Ibrahim at 713-794-2990.

  
M. desVignes-Kendrick, MD, MPH  
Director  
Houston Department of Health and  
Human Services

Xc: Mayor's Office  
Susan Bandy, Assistant Director, F & A  
Earl Travis, Deputy Director, Houston Department of Health & Human Services  
Monir Ibrahim, Division Manager, Houston Department of Health & Human Services  
Deoniece Arnold, RN, MBA, Bureau Chief, Houston Department of Health & Human Services  
Kate Pitts, RPH, PharmD, Chief Pharmacist, Houston Department of Health & Human Services  
Sharon Marsh, Assistant Director, Houston Department of Health & Human Services  
Steve Schoonover, City Auditor, City Controller's Office  
Kenneth Teer, Audit Manager, City Controller's Office

Attachment

*Views of Responsible  
Officials*

**AUDIT FINDINGS, RECOMMENDATION  
AND MANAGEMENT'S RESPONSES**

**I. SLOW TURNOVER OF INVENTORY ITEMS**

**FINDING**

Our analysis of the inventory at Warehouse 042 revealed that \$486,861 (97%) of the \$501,102 total inventory on hand, would be in inventory an average of 3 years. Of the \$486,861, \$67,195 of the commodities has a supply greater than one but less than 10 years. The remainder, \$14,241 (3%) will be in inventory an average of approximately 2 months.

The cost of acquiring, warehousing, and managing excessive quantities of inventory is an unnecessary commitment of City resources and exposes the inventory to obsolescence and misappropriation.

**RECOMMENDATION**

We recommend that management dispose of excess and obsolete items and draft and adopt Standard Operating Procedures to include a schedule for a periodic review to remove obsolete items from the stock.

**MANAGEMENT RESPONSE  
COMMENTS**

Emergency supplies, medications and various miscellaneous supplies, while not used frequently, are required for the maintenance of emergency carts, to be available in the event of an emergency situation, mass casualty biological event and/or are required to be available upon request of clients in compliance with Title V, Title XIX and Title XX Grants. i.e., epinephrine, IV solutions and birth control devices. This listing was reviewed in detail with the auditor.

**RESOLUTION**

We will review the current usage and re-evaluate amount needed to be maintained. We will develop a policy, which includes review and evaluation on a periodic basis. Inventory audits, which are currently done twice per year will be followed by outcome and review meetings where results are discussed and reviewed with appropriate

*Views of Responsible  
Officials*

personnel and management.

- Current internal audit being done February 9, 10 and 11, 2004
- Outcome meetings held by March 15, 2004
- Review and evaluation of emergency carts, drugs and supplies will be included in routine internal Quality Assurance Review audits per clinic during 2<sup>nd</sup> and 3<sup>rd</sup> quarter of 2004.

## II. UNANNOUNCED INVENTORY COUNTS

### FINDING

Our testing revealed significant differences between the perpetual records and the physical inventory counts as follows:

- The "Quantity on Hand" per the inventory Status Report did not agree to the auditors' physical inventory count for 95%(57 of 60) of the sample items reviewed.

### RECOMMENDATION

A cycle count concentrates efforts on the inventory with the highest issue activity value and the highest risk of error. To identify differences between actual inventory quantities and the perpetual records, we recommend that management routinely perform inventory cycle counts. Management should then determine the cause of the differences and take appropriate corrective action.

*Views of Responsible  
Officials*

### MANAGEMENT RESPONSE COMMENTS

Numerous discrepancies were noted, however; several factors influence the number of discrepancies in "quantity on hand" found during inventory counts, which are related directly to the Advantage System. Each of these factors has the propensity to skew the volume and directly affect the inventory status. All of these functions are performed by one individual within the Pharmacy.

### **Internal Processes**

- All deliveries/"receivables" must be entered into the Advantage System.
- The Advantage System frequently alters the unit of purchase. This requires the added administrative burden of correcting each unit of purchase to the correct unit of dispensation for each item that is altered in the system. i.e., cases to bottles or bottles to tablets. This must be done each time there is a delivery and a receipt of an item.
- Each order must be entered into Advantage by an **external site** (clinic) and after that entry the Pharmacy is able to "confirm" delivery in the Advantage System.
- All expired drugs and/or returns must be entered into the Advantage System.
- Majority of deliveries and supplies are entered by Pharmacy at the **beginning** of the month.
- Majority of **corrections and confirmations** are entered by Pharmacy at the end of the month.
- Data entry had not been completed when this audit was performed.

### **External Processes**

- External customers (clinic personnel) are required to enter supplies into the Advantage **before** confirmation can be entered by the Pharmacy. Delays, omissions and non-compliance by external personnel have directly affected the inventory status reports. We have subsequently sent memos requiring compliance and data input within a specified period of time. All staff has been made aware of mandatory timetables and data input requirements.
- Perpetual variances exist due to the method of implementation and installation of the Advantage System several years ago. The Advantage System was initially installed within the Pharmacy. Then, subsequently each clinic (Northside, La Nueva Casa, Riverside, Sunnyside, Magnolia, Westend, and Lyons) was sequentially brought onto the database. In some instances there was a delay in the installation. Records have been updated on a manual basis to bridge gaps.

*Views of Responsible  
Officials*

**RESOLUTION**

The department will develop a small inter-disciplinary work group to review the current processes and the Advantage System. The Group will make recommendations for improvements by 09/01/04.

**III. ABSENCE OF WRITTEN POLICES AND PROCEDURES**

**FINDING**

The Central Pharmacy does not have in place written policies and procedures detailing how to account for inventory. Absence of procedures may have caused some of the noted issues.

**RECOMMENDATION**

We recommend that the Central Pharmacy immediately develops written policies and procedures to account for inventory and that its staff becomes trained in record keeping.

**MANAGEMENT RESPONSE  
COMMENTS**

We have numerous Policy and Procedure Manuals, which meet the Federal, State regulations and Texas Department of Health operating standards and guidelines. They consist of the following policies to name a few:

Personnel  
Security  
Equipment  
Sanitation  
Licensing  
Reference Material  
Dispensing  
Storage  
Drug Pre-packaging  
Quality Assurance Control  
Supervision  
Labeling  
Drug Sampling  
Drug Destruction and Returns  
Procurement  
Receiving

*Views of Responsible  
Officials*

Record keeping  
Inspection  
Drug Recall  
Standing Order's for Dental, Women's and Children's Health,  
Immunization, STD and Tuberculosis Programs

In addition, we have a Pharmacy and Therapeutics Committee which meets periodically, to review, revise and develop policies, procedures, processes and update drug formulary. This committee also reviews the outcomes of Quality Assurance Audits of Health Centers and their corresponding medical records. However, there is not a specific policy and procedure related to commodity codes, bin labels and corresponding inventory variances.

**RESOLUTION**

Policies regarding inventory and variance procedures are in development. Appropriate training will be provided to all.

**IV.   MAXIMUM/MINIMUM           REORDERING           POINTS           NOT  
      ESTABLISHED**

**FINDING**

Our review disclosed that the Central Pharmacy has not established the maximum or minimum amounts of medicines that should be on hand.

Establishing a maximum is essential as it will minimize excessive inventory levels exposure to obsolescence and misappropriation.

Establishing the minimum amounts to be on hand is critical as it ensures sufficient quantities are on hand to avoid a shortage of medicines.

**RECOMMENDATION**

We recommend that the Central Pharmacy establish maximum or minimum reordering points to eliminate the excess or shortage of medicines.

*Views of Responsible  
Officials*

**MANAGEMENT RESPONSE  
COMMENTS**

It was our original intent with the implementation of the Inventory Control System of Advantage and the establishment of routine purchasing contracts through Strategic Purchasing for the Pharmacy to utilize the historic data to determine maximum and minimum drug usage, control and monitor volume delivery and reduce stockpiling.

To assist Strategic Purchasing in this endeavor we have provided the following:

- Reviewed of all contract bids (76 vendors)
- Asked Strategic Purchasing for "special consideration" and separate bids and vendors for the Pharmacy because of contract pricing and inability of selected vendor to supply medications.
- Identified the **three best vendors**
- Identified potential obstacles to treatment based on various vendor increases in pricing, which were due to occur at expiration of contracts, which were in place. (Birth control pills)
- Preceding contract expiration we purchased large-scale amounts of one or two items before vendor increase in pricing by one thousand percent (1000%). (They would no longer sell birth control pills at retail pricing). These required specific dollar figures be approved by City Council.

*Views of Responsible  
Officials*

Despite all efforts Strategic Purchasing still has ***no contract in place***. Every item within the Pharmacy, which is not on the State Contract, has to go through the "three bid process". The three-bid process has inherent delays and disadvantages. We purchase in bulk to leverage pricing. This vicious circle does not currently allow for maximum, minimum or sufficient quantities at reasonable prices. Essential supplies are always in "crisis delay" basis.

In an effort to control cost and prevent stockpiling of medications a Pharmacist(s) are assigned to specific clinic(s). Pharmacists go to the clinic and determine amount of medications and supplies needed. Orders are based on Pharmacists recommendations. Despite contractual



difficulties and delays the Pharmacy maintains stringent ordering practices and constantly scrutinizes costs and vendor services. This "safeguarding" has resulted in a reduction of expenditures of \$200,000 - \$500,000 within the last 3 years.

**RESOLUTION**

After reviewing usage reports, we will establish maximum and minimum usage levels. However, some maximum levels may be considered excessive due to the need to purchase in bulk to take advantage of pricing, no contracts and delays in delivery time.

**V. NO BIN ON THE WAREHOUSE SHELVES**

**FINDING**

Bin labels help ensure that warehouses remain organized and make it easier to compare the actual inventory quantities to the perpetual records. An inventory bin label was not affixed to the bin location on the Central Pharmacy Warehouse shelves for 44 out of 60(74%) items that were tested.

*Views of Responsible  
Officials*

**RECOMMENDATION**

We recommend that the Central Pharmacy attach bin labels to the bin locations that do not have a label. The labels should include the part description, commodity code number, and unit of measure and bin and row numbers.

**MANAGEMENT RESPONSE  
COMMENTS**

Late this summer the shelves in the Pharmacy were dismantled for asbestos removal. They were reinstalled hurriedly by temporary personnel without regard for commodity codes/bin numbers in matching and corresponding order. In order to maintain security and safety of medications and supplies Pharmacists restocked the medications on the shelves. Because Pharmacists relate to specific names of medications and stock and extract their individual supplies they put the medications

back according to names and in alphabetical order with no regard for the commodity code nor bin location.

**RESOLUTION**

All commodity codes, labeling of all shelves with the corresponding numbers to medications have been completed.

**VI. COMMODITY CODES DID NOT AGREE**

**FINDING**

The commodity codes at the bin location should correspond to the perpetual records to help maintain inventory control. The commodity codes of the Warehouse Status Report for 48 of 60(80%) items that were tested.

**RECOMMENDATION**

We recommend that the Central Pharmacy review and correct the differences between the commodity codes at the bin location and the commodity codes of the Warehouse Status Report.

*Views of Responsible  
Officials*

**MANAGEMENT RESPONSE  
COMMENTS**

Late this summer the shelves in the Pharmacy were dismantled for asbestos removal. They were reinstalled hurriedly by temporary personnel without regard for commodity codes/bin numbers in matching and corresponding order. In order to maintain security and safety of medications and supplies Pharmacists restocked the medications on the shelves. Because Pharmacists relate to specific names of medications and stock and extract their individual supplies they put the medications back according to names and in alphabetical order with no regard for the commodity code nor bin location.

**RESOLUTION**

All commodity codes, labeling of all shelves with the corresponding numbers to medications have been completed.

**VII. INACCURATE ORDER FORM**

**FINDING**

Order form used by the health centers help ensure accurate records. The commodity codes for 6 of 25 (24%) item we tested differed on the order forms from the warehouse Status Report provided by the City's Strategic Purchasing Division and the Pharmacy's Catalog for 2003 Medication.

**RECOMMENDATION**

We recommend that the Central Pharmacy revise the order form to reflect the category codes of the Pharmacy's Catalog for 2003 Medication.

**MANAGEMENT RESPONSE  
COMMENTS**

To control ordering, eliminate stockpiling and clinical staff hoarding medications the Pharmacists go to the clinic and using a "old order form", which is kept in the clinic pharmacy, makes a list of medications and supplies needed. As indicated above, our Pharmacists did not utilize nor consider commodity codes in this process. They order according to names of drugs. We had hundreds of these forms left at each clinic. In an effort to minimize reproduction cost, and promote "recycling" the Pharmacists were instructed to continue to utilize these "old forms" until they no longer exist.

Pharmacy Catalogs with commodity codes were specifically developed for clinic personnel usage. These catalogs were distributed to the designated "order clerk" at the clinic at the time of instruction by the Pharmacy Office Supervisor (2002/2003). This is the catalog that is utilized by clinic personnel for data entry into the Advantage System.

*Views of Responsible  
Officials*

**RESOLUTION**

We will eliminate the commodity codes from this old form.

04 FEB 13 PM 12:35  
CONTROLLER'S