OFFICE OF THE CITY CONTROLLER

HEALTH AND HUMAN SERVICES DEPARTMENT

UNANNOUNCED INVENTORY AUDIT
DENTAL WAREHOUSE

Annise D. Parker, City Controller

Steve Schoonover, City Auditor

Report No. 04-14

OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

August 13, 2004

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: Houston Department of Health and Human Services
Unannounced Inventory Audit – Dental Warehouse (Report No. 04-14)

Dear Mayor White:

The City Controller's Office Audit Division has completed an Unannounced Inventory Audit of the Department of Health and Human Service's (Department) Dental Warehouse located at 1809 N. Main. The audit objective was to assist management with the assessment of the adequacy of internal controls related to physical inventory management at the warehouse location. Additionally, the audit was to evaluate compliance with department standard operating procedures.

The report, attached for your review, concluded that internal controls over 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 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.

We commend the Department for taking prompt action to implement the recommendations. Also, we appreciate the cooperation extended to our auditors by Department personnel during the course of the audit.

Respectfully submitted,

Annise D. Parker
City Controller

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

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SCOPE AND PURPOSE

Our scope consisted of conducting an unannounced inventory count and reviewing inventory management procedures at the Houston Department of Health and Human Services (HDHHS) 1809 N. Main Warehouse as of April 27, 2004. 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 HDHHS inventory at the Dental Clinic Warehouse are not adequate to provide Department management with reasonable assurance that physical inventories are properly safeguarded and managed.

Linda McDonald
Auditor-in-charge

Kenneth Teer
Audit Manager

Steve Schoonover
City Auditor

INTRODUCTION

On April 27, 2004, Controller's Office auditors attempted to conduct an unannounced inventory audit of Houston Department of Health and Human Service's Dental Clinic Warehouse located at 1809 N. Main. The Dental Clinic Warehouse supplies dental supplies and materials to four health centers which are La Nueva Casa De Amigos Health Center, Lyons Avenue Health Center, Northside Health Center and West End Health Center. Examples of inventory items noted were toothbrushes, crowns and syringes. The value of the inventory on the date of the audit as reflected in the financial records was approximately $152,000.

AUDIT FINDINGS AND RECOMMENDATIONS

I. INCOMPLETE INVENTORY REPORTS

BACKGROUND

It is Department management's responsibility to ensure that accurate inventory records are maintained. The City of Houston (COH) departments with warehouse facilities are required to post their transactions to the COH Advantage Financial Management system on a timely basis. From these entries, the Strategic Purchasing Department creates and posts various inventory reports for the COH Warehouses available on the City's Intranet program (C.H.O.I.C.E.). City Management can then refer to these reports to obtain inventory data relevant to the City's various warehouses.

FINDING

On the morning of April 27, 2004, the audit team arrived at the Houston Department of Health and Human Service's (HDHHS) Dental Clinic Warehouse No. 041 located at 1809 N. Main to conduct an unannounced inventory audit. The person in charge of the warehouse is the Bureau Chief. Pursuant to a discussion with the Bureau Chief, it was determined that an inventory count of this warehouse would not be practical at this time. The reasons for this decision are discussed below.

The Bureau Chief stated that in the past, two (2) persons had been in charge of the warehouse. However, both individuals had left the department. These two positions were eliminated when the City determined it necessary to eliminate these vacant positions. The Bureau Chief advised that she was now responsible for the warehouse. Further discussions revealed that the last inventory count was performed in October 2003. Since then, the receiving and shipping reports have been forwarded to the financial section of HDHHS. The Bureau Chief's understanding was that the HDHHS financial section was making the appropriate inventory entries to Warehouse No. 041's inventory, based on the paperwork she transferred to them. However this was not the case. As a consequence, the

warehouse inventory records are incomplete. The Bureau Chief noted she intended to complete the inventory reports by June 30, 2004.

RECOMMENDATION

We recommend the Dental Bureau personnel begin updating their warehouse records to properly reflect the warehouse levels, while concurrently posting inventory transactions on a timely basis. We further recommend the Bureau Chief adhere to the June 30, 2004 deadline she established.

II. WRITTEN POLICIES AND PROCEDURES

FINDING

Written policies and procedures help ensure that inventory is safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and are recorded properly. On May 18, 2004, the Bureau Chief indicated there are written inventory policies and procedures in place. Upon request of the auditors, on May 20, 2004, she provided a copy of such procedures. She also indicated the policies are incomplete and will require updating and editing. We concur with her assessment.

RECOMMENDATION

We recommend the Department continue updating and editing the internal policies and procedures. We also recommend designated staff for the warehouse be trained in record keeping and inventory management.

EXHIBIT I

CITY OF HOUSTON
Health and Human Services Department

CONTROLLER'S
04 JUL 22 AM 9:59

Interoffice
Correspondence

To: Annise D. Parker
City Controller

From: Stephen L. Williams, M.Ed, M.P.A.
Health and Human Services

Date: July 20, 2004

Subject: **Status Report - Unannounced Inventory Audit - Dental Warehouse**

Attached please find the Houston Department of Health and Human Services' (HDHHS) response to the Unannounced Inventory Audit dated April 27, 2004. This status report gives a current standing on the proposed resolution to each of the two findings:

- Incomplete Inventory Reports

Finding
On the morning of April 27, 2004, the audit team arrived at the Dental Clinic Warehouse No. 041 located at 1809 N. Main to conduct an inventory audit. The person in charge of the warehouse is the Bureau Chief. Pursuant to a discussion with the Bureau Chief, it was determined that an inventory count and audit of this warehouse would not be practical at this time. The reasons for this decision are discussed below.

The Bureau Chief stated that in the past, 2 persons had been in charge of the warehouse, however, both individuals had left the department, and the positions were eliminated. The Bureau Chief advised that she was now responsible for the warehouse. Further discussions revealed that the last inventory count was performed in October 2003. Since then, the receiving and shipping reports have been forwarded to the financial section of HDHHS. The Bureau Chief's understanding was that the HDHHS financial section was making the appropriate inventory entries to Warehouse No. 041's inventory, this not the case. As a consequence, the warehouse inventory records are incomplete.

Views of Responsible Officials

Recommendation
We recommend that Dental Warehouse personnel begin updating their warehouse records to properly reflect the warehouse levels; while concurrently posting inventory transactions on a timely basis.

Management Response
HDHHS has assigned the appropriate staff in the Community and Personal Health Services Division (CPHS) to continuously monitor the Dental Warehouse No. 041 activities and continuously update warehouse records to properly reflect inventory levels. The records update will be completed by Monday, November 15, 2004

EXHIBIT I

- Absence of Written Policies and Procedures

Finding
The Dental Clinic does not have in place written policies and procedures detailing how to account for inventory. Absence of written procedures may have caused the noted misunderstanding, and could result in future issues.

Recommendation
We recommend that management develop written policies and procedures for the Dental Clinic to account for inventory and also that its warehouse staff become trained in record keeping and inventory management.

Management Response
HDHHS has assigned the appropriate staff with the CPHS division to review current practice and processes. All processes have been mapped and operating policies and procedures revised, documented and approved. All inventory control personnel will be trained/retrained on revised procedures by Tuesday, October 19, 2004.

HDHHS is exploring a "Just in Time" Delivery system through a private supplier for the Dental Warehouse. This will eliminate the need for a Dental Warehouse. Expectations are that this will be a more efficient system for the dental clinics, reducing supply costs and the need for staffing and management. Reports on this project will be available on a monthly basis with an estimated completion date of January 24, 2005.

If you have any questions, please contact me at (713) 794-9980 or Martee Engel, DDS, Assistant Director, Community and Personal Health Services Division at (713) 794-9350.

Stephen L. Williams, M.Ed, M.P.A.
Director
Houston Department of Health
and Human Services

SLW:dv

xc: Daphine Sands
Martee Engel, DDS
Johanna K. DeYoung, DDS
Kenneth Teer

Views of Responsible Officials