

University of California
San Francisco



Audit Services

November 30, 2010

KEVIN PATTISON

Director
Supply Chain Management
Materiel Services Administration

**SUBJECT: Materiel Services – Receiving & Inventory Controls
Audit Services Project #11-017**

As a planned audit for fiscal year 2010-2011, Audit Services has completed a review of Materiel Services' receiving and inventory controls. Attached is the final report incorporating the observations and agreed upon management corrective actions.

The management actions specified in this report will be added to the Audit Services follow-up system. Periodically, the Materiel Services department will be contacted to ascertain the status of implementation for these corrective actions. Once implemented, additional audit procedures may be performed to validate actions taken. You will be notified when all corrective actions have been implemented and we consider this audit closed.

I would like to thank you for your assistance and cooperation during this review. Please do not hesitate to contact me at (415) 502-2238 should you have questions.

Sincerely,

A handwritten signature in cursive script that reads "Rick Catalano".

Rick Catalano
Director

c: Controller Farmer
 Management Services Officer Abiol
 Management Services Officer Jakic

Audit Committee

Chief Medical Officer Adler
Executive Vice Chancellor & Provost Bluestone
Vice Chancellor & Chief Information Officer Harel
Vice Dean Hindery
Chief Operating Officer Jones
Senior Vice Chancellor Plotts
Information Security Officer Rusting
Associate Dean Schultz
Chief Financial Officer Strickland
Senior Vice President Vacca
Associate Vice Chancellor Vermillion

**UNIVERSITY OF CALIFORNIA, SAN FRANCISCO
AUDIT SERVICES**

**MATERIEL SERVICES – RECEIVING & INVENTORY CONTROLS
Project #11-017
November 2010**

Fieldwork Performed by:

Paul Lapachet, Senior Auditor

Reviewed by:

Zuleikha Shakoor, Senior Associate Director

Approved by:

Rick Catalano, Director

MANAGEMENT SUMMARY

As a planned audit for fiscal year 2010-2011, Audit Services reviewed Material Services' receiving and inventory controls.

Material Services is responsible for the operation and performance of the UCSF Medical Center's supply chain. Functions included in this responsibility consist of receiving and distributing shipments for the UCSF Medical Center, and furnishing patient care areas with hospital and general supplies. Supporting these functions is the Materials Management Information System group. Additionally, Material Services posts patient charges for custom orthotics and prosthetics made by the Orthotic and Prosthetic Center.

The purpose of the review was to assess management's controls over supplies flowing through Material Services. Our review included evaluation of processes and procedures for receiving and distributing goods, inventory management including setting inventory PAR levels, annual year-end physical inventory and physical security and system access controls. Additionally, we reviewed the patient billing procedures for custom orthotics and prosthetics.

Based on work performed, overall Material Services' internal controls over the receiving, custody and distribution of supplies are adequate. Management's procedures are effective to help ensure that UCSF Medical Center shipments are received and distributed accurately, completely and timely. Suitable inventory management controls have been developed and implemented by management. However, controls could be strengthened through implementation of regular review process of periodic inventory adjustments and of user access to the inventory management system. Additionally, the accuracy of the annual year-end physical inventory counts could be improved to assure correct reporting for the financial statements and an alignment between the documented procedures and actual performance of the recounts during the annual year-end physical inventory count needs to occur.

More detailed information can be found in the body of this report.

TABLE OF CONTENTS

MANAGEMENT SUMMARY i

TABLE OF CONTENTS ii

I. BACKGROUND 1

II. PURPOSE AND SCOPE 1

III. CONCLUSION 2

IV. OBSERVATIONS AND MANAGEMENT CORRECTIVE ACTIONS 3

 A. Inventory Adjustments 3

 B. Annual Physical Inventory 3

 C. System Access 4

I. BACKGROUND

As a planned audit for fiscal year 2010-2011, Audit Services reviewed Material Services’ receiving and inventory controls. Among other functional responsibilities, the Material Services department is responsible for the overall operation and performance of UCSF Medical Center’s supply chain. For fiscal year 2010, Material Services had 139 FTE and total revenue of \$10,291,971 and expense of \$22,974,859. The Receiving and Distribution units with Material Management have the following responsibilities:

- Receiving: Accepts all incoming shipments of medical/surgical supplies, equipment, and non-medical deliveries for UCSF Medical Center as well processing all outgoing shipments for the hospital. For fiscal year 2010, the Receiving unit had 15 FTE and \$1,250,848 in total expense.
- Supply and Distribution: Maintains and distributes general, medical/surgical supplies and equipment to all patient care areas for Mount Zion and Moffitt-Long Hospitals. Assemble and package small procedure kits; restocks and transports specialty case carts. In fiscal year 2010 the total value of supplies that passed through the Material Services storeroom at Moffitt hospital was approximately \$4.2 million. For fiscal year 2010, Supply and Distribution had 64 FTE, total revenue of \$7,477,208 and total expense of \$11,392,850.

These groups are supported in their mission by Materials Management Information Systems group. This group provides information system support to all Material Management units. The primary system used by management for receiving and inventory control is Pathways Materials Management (PMM). In addition to the responsibilities stated above, Material Services posts patient charges for custom orthotics or prosthetics made by the Orthotic and Prosthetic Center (OPC). The Material Services cost center recognizes the expense from OPC and the revenue from the patient for these devices. This type of activity is not customary for material services operations.

II. PURPOSE AND SCOPE

The purpose of this audit was to review and assess the controls over supplies flowing through Material Services. Specifically, the audit focused on:

- Receiving and distribution procedures
- Inventory management
- Physical control and storage of centrally maintained inventory
- Year-end and periodic physical inventory counts
- System access controls
- Patient billing for custom orthotic and prosthetic supplies

To complete this review, the following procedures were performed:

- Receiving documents were reviewed to determine if shipments were:
 - Recorded in PMM accurately and
 - Delivered to end users completely and on a timely basis.
- Management’s analysis of inventory levels was reviewed to determine if sufficient controls were in place to ensure that inventory levels were set at an appropriate level.
- The annual year-end physical inventory was observed to determine if management’s procedures are sufficient to ensure that inventory balances are fairly reported in the financial statements.
- Accounting write–offs and inventory adjustments recorded in PMM were reviewed to determine if inventory adjustments are reviewed, supported by adequate documentation and appropriately approved.
- The expense for items issued to end users was reviewed to determine if supplies are correctly recharged to the end user.
- Logical access to PMM system was reviewed to determine if access is appropriate for job duties.
- Access to the Material Services inventory storeroom was reviewed to determine if physical security of the inventory is appropriately controlled.
- Work-orders and patient charges for custom orthotic and prosthetic supplies from the OPC were reviewed to determine if:
 - Patient billing was properly recorded and
 - OPC expense was properly recognized.

The scope of the review was limited to the specific procedures describe above and related to transactions and activities occurring between July 2009 and June 2010 at the Parnassus location. Fieldwork was completed in September 2010.

III. CONCLUSION

Based on work performed, overall Material Services’ internal controls over the receiving, custody and distribution of supplies are adequate. The receipt of goods is recorded accurately, completely and timely. Management’s review and setting of inventory levels was found to be appropriate. Physical access to Material Services’ inventory is appropriately controlled. Additionally, the posting of patient charges for OPC appliances is properly recorded. However, controls could be enhanced through the implementation of regular reviews of cycle counts inventory adjustments; improved procedures for re-count of inventory to assure greater accuracy for year-end financial statement reporting and periodic review of access accounts to the PMM system should occur to assure that only authorized personnel are granted access.

IV. OBSERVATIONS AND MANAGEMENT CORRECTIVE ACTIONS

A. Inventory Adjustments

Cycle count inventory adjustments are not reviewed and approved as required by University Policy.

Material Services staff perform cycle counts on a daily basis for storeroom inventory. In this process, a small subset of inventory is counted daily and inventory adjustments are posted to PMM. For Fiscal Year 2010 there were approximately 6,400 cycle count inventory adjustments, which resulted in a net increase of \$418,000 to the Material Services storeroom inventory.

We noted that inventory adjustments posted to PMM were not reviewed and approved as required by Business and Finance Bulletin BUS- 54, Operating Guidelines for University Supply Inventories. An established program of monitoring inventory adjustments promotes effective inventory management and control plus ensures accurate financial reporting.

Management Corrective Action

By December 1, 2010 Management will implement a weekly review of inventory adjustments posted to PMM due to cycle counts. Using the Balancing Inventory Adjustment Log as the basis for their review, adjustments over \$1,000 will be reviewed to obtain the reasons behind the adjustments and to identify trends, which may warrant further analysis. Records will be created to document the reason for each adjustment and adjustment notes will be placed under each adjustment in question, providing explanations. The adjustment log will be signed off to denote evidence of the review by management. All records associated with adjustments will be retained for two years.

B. Annual Physical Inventory

Annually, Material Services performs a complete physical count of its storeroom inventory to verify balances on-hand for the year-end financial statement reporting. Management has developed written inventory procedures for the performance of year-end physical count, including procedures for recount. Audit Services observed Material Services' year-end physical inventory at the Parnassus location to assure that the count was conducted correctly and was in line with the documented procedures. During our observation of the inventory count the following was noted:

1. *Discrepancies existed between the documented procedures and actual recount performed.*

The instructions given to the count teams on the day of the inventory varied from the documented inventory procedures as to the percentage of items to recount. Per the written inventory procedures 50% of the inventory location items were to be recounted; actual recount was 3 or 4 inventory items per Count Sheet (equating to 13-17%). The percentage of locations recounted during the physical inventory appears to be reasonable; however, this varied from the documented procedures.

Varying the instructions to the physical inventory count teams from the written policies creates the risk of confusion and the control not being implemented as designed.

2. *Inventory counts performance could be improved to assure a more complete and accurate count.*

A selected sample of items recounted by the Auditor revealed a 36% variance rate indicating inaccuracies in the original counts.¹ Inaccurate performance of inventory counts increases the risk of misstatement of the financial statements.

Management Corrective Action

By January 3, 2011 Management will make a determination on the level of recount that needs to be performed to provide the level of assurance on the accuracy of the count and update the written procedures accordingly. Additionally, the revised procedures will include a review of the error rate discovered by the recount teams. If the error rate exceeds a preset threshold for any count team, management will review the inventory procedures with these teams to identify and correct the basis for the error rate.

C. Access to PMM

Procedures need to be strengthened to ensure PMM access is revoked timely when employees leave the department.

University policy and effective system security practices dictate that access privileges be revoked in a timely manner when no longer needed.² Of the 22 Material Services user accounts reviewed on PMM, we noted that two employees, who no longer worked in the department, still had an active

¹ 4 of 11 item recounted differed from original count.

² UCOP Information Systems Bulletin IS-3, Electronic Information Security, Section III.C.2 Operational and Technical Controls;

user account and access to PMM. One individual separated employment in 2005 and records showed he had not accessed the system since that date. The other individual is still employed and his last system access was in August 2010 when he still was a member of Material Services. Procedures do not exist to ensure PMM access is immediately revoked when an employee leaves. In addition, there is no periodic review of PMM user accounts to confirm only authorized users have system access.

If access to PMM is not appropriately limited and managed, the risks exist that former departmental personnel could make inappropriate adjustments to the hospitals inventory management system.

Management Corrective Action

By December 1, 2010, Management will review the access accounts for all existing users to assure that these are valid and updated. Thereon review of user access to PMM will be performed on a quarterly basis to determine if all user access is appropriate. Documentation of this review will be maintained by the department for two years.

* * * * *