

# AUDIT REPORT



CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
BUREAU OF MANAGEMENT AUDIT  
**WILLIAM C. THOMPSON, JR., COMPTROLLER**

## **Audit Report on the Internal Controls Of the Human Resources Administration Over Its Warehouse Inventory**

*MJ02-145A*

**June 6, 2003**



THE CITY OF NEW YORK  
OFFICE OF THE COMPTROLLER  
1 CENTRE STREET  
NEW YORK, N.Y. 10007-2341

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WILLIAM C. THOMPSON, JR.  
COMPTROLLER

**To the Citizens of the City of New York**

Ladies and Gentlemen:

In accordance with the Comptroller's responsibilities contained in Chapter 5, § 93, of the New York City Charter, my office has audited the Human Resources Administration (HRA) to determine whether it has adequate internal controls over inventory at its central warehouse. HRA administers a broad range of program and services to help individual and families. The HRA Office of General Support Services provides assistance to HRA programs and oversees the warehouse.

Our audit resulted in the findings and recommendations that are presented in this report. The findings and recommendations were discussed with City officials; their comments were considered in the preparation of this report.

Audits such as this provide a means of ensuring that City resources are used effectively, efficiently, and in the best interest of the public.

I trust that this report contains information that is of interest to you. If you have any questions concerning this report, please e-mail my audit bureau at [audit@comptroller.nyc.gov](mailto:audit@comptroller.nyc.gov) or telephone my office at 212-669-3747.

Very truly yours,

*William C. Thompson, Jr.*

William C. Thompson, Jr.

**Report: MJ02-145A**  
**Filed: June 6, 2003**

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ADDENDUM

*The City of New York  
Office of the Comptroller  
Bureau of Management Audit*

**Audit Report on the Internal Controls  
Of the Human Resources Administration  
Over Its Warehouse Inventory**

**MJ02-145A**

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**AUDIT REPORT IN BRIEF**

This audit determined whether the Human Resources Administration (HRA) has adequate internal controls over inventory at its central warehouse. HRA administers a broad range of programs and services to help individuals and families. The HRA Office of General Support Services provides assistance to HRA programs, including repair and maintenance. The Office of Facilities and Management Services (OFMS) stores materials for the Construction and Maintenance divisions.

**Audit Findings and Conclusions**

Our review of the internal controls of HRA over its inventory operations disclosed significant weaknesses in the recording, security, and maintenance of inventory. These weaknesses resulted from HRA management's failure to institute the controls necessary to ensure that the warehouse inventory is properly safeguarded and accounted for.

HRA does not have written procedures for maintaining inventory. Inaccurate inventory records and inadequate security measures were evidenced by the following: our count of sampled items revealed a gross discrepancy of 21 percent between the amounts on hand and the amounts reported in the records; HRA personnel do not generally investigate discrepancies between amounts on hand and amounts recorded; and 53 (25%) of the 219 transactions we reviewed were inventory adjustments inadequately supported by HRA's records. Also, surveillance tools were not properly used, and the person in charge of security had not taken a day off in more than two years.

In such an environment, there is a high potential that goods may be lost or stolen and not detected.

**Audit Recommendations**

We made two recommendations, HRA should:

- Create an inventory project team that reports to the Commissioner or a Deputy Commissioner, whose function would be to overhaul and redesign the agency's inventory system. In re-engineering the system, this team should incorporate the inventory standards encompassed in the Department of Investigations's "Standards for Inventory Control and Management" and in Comptroller's Directive #1.
- As an alternative, if HRA does not think that it has the in-house skills necessary for an inventory re-engineering project, we recommend that HRA seek funding to hire an outside consultant to address the problems and use the future savings from its inventory operations to pay for the consultant.

### **Agency Response**

The matters covered in this report were discussed with HRA officials during and at the conclusion of this audit. A preliminary draft was sent to HRA officials and was discussed at an exit conference on April 8, 2003. On April 29, 2003, we submitted a draft report to HRA officials with a request for comments. We received a written response from HRA on May 14, 2003. In its response, HRA generally agreed with the audit's recommendations. However, HRA disagreed with the finding related to computerized inventory system malfunctions. The full text of the HRA comments is included as an addendum to this report.

## INTRODUCTION

### **Background**

The Human Resources Administration (HRA) administers a broad range of programs and services to help individuals and families. Its programs include income support, employment services, Medicaid, home care for the elderly and disabled, AIDS and HIV-related support services, and adult protective services.

The HRA Office of General Support Services (HRA Central) provides assistance to HRA programs, including capital construction planning, engineering services, and repair and maintenance. The Office of Facilities Management Services (OFMS), a component of General Support Services, stores electrical, carpentry, and plumbing materials for the Construction and Maintenance divisions in its central warehouse. The central warehouse is located on 11<sup>th</sup> Avenue, from West 26<sup>th</sup> Street to West 27<sup>th</sup> Street, in Manhattan. The HRA warehouse occupies the entire 4<sup>th</sup> floor and half of the 1<sup>st</sup> floor garage area. The warehouse contains various items, such as pipes, pipe fixtures, electrical wiring, drywall, doors, air conditioners, toilets, refrigerators, and stoves. These materials are used for new construction or repairs of HRA facilities. For Fiscal Year 2002, HRA reported that its year-end inventory had a value of \$1,096,326.

We audited HRA warehouse inventory operations in 1993 and 1997. Those audits identified a number of weaknesses in HRA's administration of its inventory, such as: maintaining excess inventory; maintaining incomplete and inaccurate records for inventory at the warehouse; and not appropriately segregating warehouse responsibilities among OFMS personnel. In response to the 1997 audit, HRA indicated that a new inventory system would be ready for operation in January 1998.

### **Audit Objective**

The objective of the audit was to determine whether HRA has adequate internal controls over inventory at its central warehouse.

### **Scope and Methodology**

The audit scope was July 1, 2001, through February 5, 2003.

To determine whether HRA has adequate internal controls and procedures at its warehouse and complied with the *Standards for Inventory Control and Management* issued by the Department of Investigation Corruption and Management Bureau, we evaluated its inventory practices and procedures and applied these standards when reviewing HRA's practices and procedures.

To understand the daily practices of the warehouse, and to determine whether there is adequate segregation of duties, we interviewed warehouse officials and personnel responsible for the inventory functions. In addition, we performed a walkthrough to gain an understanding of the inventory record system. We observed record-keeping practices and procedures and

inventory maintenance. Based upon our walkthrough and observations, we prepared a flowchart of the inventory record system used by the warehouse.

To determine whether HRA maintains accurate inventory records, we performed a physical inventory count. From the total population of 2,898 items, we selected a random sample of 38 items. (Only items reported by HRA to have a unit cost of \$100 or more and total value of \$1,000 or more as of March 7, 2002, were included in the analysis.) The reported value of the items in our sample totaled \$2,279,052 (76%) of the reported total of \$3,008,430 in inventory. During the course of our physical count in October 2002 we discovered that, due to unit counting errors, two of the sampled items had been overstated by over \$2 million when we selected our sample in March 2002. As a result, the corrected values of the 38 sampled items and HRA's total inventory as of October 2, 2002 (prior to our count) were \$81,892 and \$1,090,937, respectively.

We conducted our physical count on October 2, 2002, together with HRA warehouse staff. We counted items on hand and compared the totals counted with the amounts recorded in the inventory records. When there were large differences, we recounted the items. At the completion of the counts, we brought the final differences to the attention of the warehouse supervisor, who confirmed the results of our count. On April 24, 2002, and May 8, 2002, prior to our physical inventory count, we observed HRA personnel performing their annual physical inventory count.

To determine the reliability and accuracy of the computerized data, we (1) traced a sample of purchase orders to and from the warehouse files and its computerized inventory system (Assetworks); and (2) traced a sample of material requests (releases) to and from Assetworks.

\* \* \* \* \*

This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) and included tests of the records and other auditing procedures considered necessary. This audit was performed in accordance with the audit responsibilities of the City Comptroller as set forth in Chapter 5, §93, of the New York City Charter.

### **Discussion of Audit Results**

The matters covered in this report were discussed with HRA officials during and at the conclusion of this audit. A preliminary draft was sent to HRA officials and was discussed at an exit conference on April 8, 2003. On April 29, 2003, we submitted a draft report to HRA officials with a request for comments. We received a written response from HRA on May 14, 2003. In its response, HRA generally agreed with the audit's recommendations. However, HRA disagreed with the finding related to computerized inventory system malfunctions. The full text of the HRA comments is included as an addendum to this report.

## FINDINGS AND RECOMMENDATIONS

Our review of the internal controls of HRA over its inventory operations disclosed significant weaknesses in recording, security, and the maintenance of the inventory that resulted from HRA management's failure to institute the controls necessary to ensure that the warehouse inventory is properly safeguarded and accounted for.

HRA does not have written procedures for maintaining inventory. We found the following inaccurate inventory records and inadequate security measures:

- Our count of sampled items revealed a gross discrepancy of 21 percent between the amounts on hand and the amounts reported in the records.
- HRA personnel do not generally investigate discrepancies between amounts on hand and amounts recorded.
- Fifty-three (25%) of the 219 transactions we reviewed were inventory adjustments inadequately supported by HRA's records.
- Surveillance tools were not properly used.
- The person in charge of security had not taken a day off in more than two years.

In such an environment, there is a high potential that goods may be lost or stolen and not detected.

### **Inventory Management Problems**

HRA management failed to institute proper controls over its inventory operations. As a result, it is unable to ensure that waste and mismanagement of inventory are minimized and that inventory is effectively protected against theft.

The goal of effective inventory management is to ensure that an adequate amount of goods is on hand to meet operational needs and that inventory costs are appropriate. We believe that the failure of HRA management to properly monitor its inventory operations and to promulgate written procedures, contributed to HRA's ineffective internal controls over its inventory operations.

All mayoral agencies are required to use the *Standards for Inventory Control and Management* of the Department of Investigations (DOI standards) as a guide in developing their own policies and procedures for the receipt, storage, distribution, and control of their inventories. Agencies are allowed to develop standards more stringent than DOI's, but must, at a minimum, follow the DOI standards.

DOI Standard #6 states that:

“Agency management is responsible for ensuring that there are policies and procedures and that these are updated to include the requirements established in these standards. Policies and procedures that detail the objectives to be achieved,

the responsibilities of each, and the methods to be used are distributed, or made available, to all staff.”

HRA management failed in its responsibility to provide clear direction to its staff in the form of written policies and procedures so that staff could properly maintain HRA inventory. (At the exit conference for this audit, HRA officials referred us to an Assetworks operations manual which they said contained inventory procedures. However, the manual merely describes how transactions should be entered on the system; it does not contain operational procedures for maintaining inventory, such as how to conduct an inventory count.) As a result, we found numerous weaknesses, such as overstatement of inventory, inadequate record-keeping, and improper inventory adjustments.

In March 2002, HRA provided us with a detailed listing of all inventory items at the warehouse; items totaled \$3,008,430. When we conducted our inventory count in October 2002, however, the inventory value we were initially given was overstated by \$2,159,145 because the warehouse staff used the incorrect unit of measure when accounting for two items. (This is discussed further on page 8.)

Our test of the reliability of the inventory records identified a gross discrepancy of 21 percent between amounts on hand and amounts recorded for the sampled items. Moreover, 53 (25%) of the 219 transactions we reviewed were inventory adjustments without appropriate justification. Because of HRA’s poor recordkeeping, the agency is unable to determine the level of stock it has on hand.

Knowing the level of stock on hand would benefit HRA by: 1) lowering the amount of overstocked items on hand, which would reduce the risk of losing inventory through damage, theft, or obsolescence; and (2) increasing the amount of understocked items on hand, which would reduce the risk of not having inventory available when it is needed.

However, because it has an ineffective inventory system, HRA lacks the capability to track: inventory turnover rates, minimum or maximum stock levels, and reorder points for stock items. Inventory turnover rate is the rate at which the inventory will be depleted and restocked during a year. Inventory turnover is a basic measure of the efficiency of inventory operations. A high inventory turnover rate with minimal shortages indicates that management is maintaining a low level of inventory while meeting the agency’s operational needs. A low inventory turnover rate indicates that management is maintaining an excessively high level of inventory. Inventory turnover is used by management to determine the minimum and maximum stock levels for inventory items. Minimum and maximum stock levels are indicators to help ensure that items do not go out of stock and are not overstocked. Reorder points indicate when orders should be placed to replenish stock items to ensure that they do not go out of stock.

Because of inaccurate recordkeeping, neither the computer system nor its manual records can be used to establish inventory turnover rates, minimum and maximum stock levels, or reorder points. As a result, according to the warehouse supervisor, HRA personnel base stock reordering upon visual inspection. This ordering is haphazard and limits management’s ability to properly manage its inventory to prevent overstocking and shortages. If HRA improved its

record-keeping of stock use, it would be better equipped to supply items when they are needed, at minimal expense to the agency.

**Inaccurate Inventory Records: 21 Percent Gross Discrepancy between Amounts on Hand and Amounts Reported in Records**

Our physical inventory count showed that HRA inventory records were inaccurate. Our count of 38 items, valued at \$81,891, revealed a gross discrepancy for 10 items valued at \$16,926 (21%) between our count and that reported in HRA inventory records. Because of inadequate controls over record-keeping, HRA lacks an accurate count of what is on hand, increasing the risk that inventory may be lost or stolen.

Accurate inventory records are necessary to maintain sufficient control over inventory levels. At best, poor record-keeping will produce questionable inventory statistics and can result in unauthorized inventory transactions. At worst, poor record-keeping makes it possible for missing or stolen items to go undetected.

DOI Standard #8 requires that “records present a complete picture of the ‘who, what, when and why’ of a transaction from initiation through completion. Records demonstrating less than this are not adequate. All authorized changes to the stock (additions or depletions) have corresponding (automated or manual) transaction records that identify the persons who authorize, move and record the data.”

To determine the accuracy of HRA’s inventory records, we conducted a count on October 2, 2002. At the time we selected our sample of 38 items, its value was reported as \$2,279,052 in a total inventory valued at \$3,008,430. When we conducted our count, however, we discovered that the values of two items had been significantly inflated because of unit-counting errors in the records, as shown in Table I below.

**TABLE I**

**Items in Sample That Were Incorrectly Priced in Inventory Records as of March 2002**

Item	Unit Price	No. of Units on Hand As Recorded	Total Value As Recorded	Corrected No. of Units on Hand	Corrected Total Value	Difference
	A	B	C (A x B)	D	E (D x A)	F (C – E)
Cable, PVC Insulated, 12 AWG	\$256.22 per roll	3,000	\$768,660	3	\$769	\$767,891
Cable, Teflon, 1 pair, 22 AWG	\$348.40 per roll	4,000	\$1,393,600	4	\$1,394	\$1,392,206
Total			\$2,162,260		\$2,162	\$2,160,098

As shown in Table I, the numbers of units for these items were severely overstated. The discrepancy is due to HRA’s using the incorrect unit of measure to account for those items in its

records. The unit of measure the staff used was “per foot,” although this item is purchased and disbursed “per roll” (one roll = 1,000 feet).

The corrected value for the 38 sampled items was \$81,892. Our physical inventory count found discrepancies between the physical count and the perpetual count (i.e., inventory records) as shown below in Table II.

**TABLE II**

Actual HRA Warehouse Shortages and Overages  
With Estimated Gross Discrepancy

Total value of inventory	Recorded Value of Sampled Items	Total Shortage	Total Overage	Net Difference	Total Difference (Gross discrepancy)	Error Variance	Estimated Gross Discrepancy for Entire Inventory
A	B	C	D	E (D-C)	F (C+D)	G (F / B)	H (A x G)
\$1,090,937	\$81,892	\$1,576	\$15,350	\$13,774	\$16,926	21%	\$225,482

As shown in Table II, the gross discrepancy for the sampled items is \$16,926—21 percent of the total recorded value of \$81,892. If we applied the error rate to the total inventory, we estimate that the discrepancy for the total inventory would be more than \$225,000. Please note that the net difference between amounts on hand and amounts reported for the sampled items is an overage of \$13,774 (i.e., more on hand than is reported in the records). This indicates that HRA does not ensure that all received items are properly recorded in its inventory records. HRA’s failure to ensure that all items that it receives are accounted for increases the risk that inventory may be lost or stolen. Since those “excess” items are not accounted for in HRA records, they are more susceptible to misappropriation because an adjustment in the records would not have to be made to conceal a theft. Nonetheless, we found numerous inventory adjustments in HRA records that were not adequately supported. This is discussed in more detail in the following section.

**Improper Adjustments to Inventory Balances**

HRA made numerous adjustments to inventory balances without proper justification. For the period reviewed, July 1, 2001, to October 3, 2002, HRA had 219 transactions—stock releases, acquisitions, and balance adjustments (changes to the inventory balance of an item without a corresponding release or acquisition of actual inventory)—for the 38 sampled items. Of the 219 transactions, 53 of them, totaling \$2,224,033, were adjustments that were inadequately supported by documentation.

As stated previously, DOI Standard #8 requires that each transaction have appropriate and adequate documentation to indicate what steps have transpired. By extension, adjustments to inventory balances should be adequately justified and documented.

When we observed HRA personnel conducting their physical count, we noted discrepancies between the amounts on hand and the amounts recorded in the system. However, rather than investigate the reasons for the discrepancies, the warehouse supervisor merely adjusted the inventory balances in her records so that they reconciled with the results of the staff's count. The supervisor stated that she ultimately has to go by the physical count provided by the staff.

To determine the degree to which inventory balances were adjusted, we reviewed transactions that occurred from July 1, 2001, to October 3, 2002, for the 38 sampled items. During that period, there were 219 inventory transactions, totaling \$4,549,645, for these items. Of the 219 transactions, 55 totaling \$4,383,178, were adjustments either to or from inventory balances. (This includes four adjustments related to the agency's using the incorrect unit of measure for two inventory items.) A breakdown is shown in Table III following.

**TABLE III**

Analysis of Adjustments Made for Sampled Items  
July 1, 2001, through October 3, 2002

	Additions		Subtractions		Total Transactions E (A+C)	Total Adjustments F (B+D)	Percent G (F/E)
	All Transactions A	Adjustments only B	All Transactions C	Adjustments only D			
Number	54	29	165	26	219	55	25%
Amount	\$2,273,759	\$2,195,778	\$2,275,886	\$2,187,400	\$4,549,645	\$4,383,178	96%

As shown in Table III, 55 (25%) of the 219 transactions were adjustments to the inventory records; these adjustments accounted for 96 percent of the total dollar value of transactions for the period reviewed. Four of the adjustments, totaling \$4,318,290, account for 95 percent of the total adjustments made. These adjustments were due to a unit counting error as shown previously in Table I. During its inventory count in October 2001, HRA personnel used the incorrect unit of measure to count two items and—without adequate investigation—improperly adjusted the inventory balances for these two items by \$2,159,145 (increase). The warehouse supervisor stated that this error was discovered in June 2002 during another inventory count. At that time, the balances for these two items were adjusted by \$2,159,145 to offset the October 2001 adjustment. According to the warehouse supervisor, the remaining 27 positive adjustments generally represented returns from job sites. However, she said that no paperwork (e.g., return receipt) was provided by the contractors or filled out by warehouse personnel, so there is no way to determine whether all returned items are accounted for. (Issues related to safeguarding inventory are discussed in more detail beginning on page 11 of this report.) According to the warehouse supervisor, the remaining 24 negative adjustments were based on physical counts performed by warehouse personnel. However, as was the case with the \$2.159 million adjustment, HRA personnel did not adequately investigate and justify the reasons for the discrepancies before making the adjustments in the inventory records. Overall, of the 55 balance adjustments, 53 (totaling \$2,224,033) were inadequately supported by documentation. (The remaining two adjustments, totaling \$2,159,145, corrected the unit counting adjustments made in October 2001.)

Allowing inventory personnel to make adjustments to the inventory records without adequate review and approval removes a key control and makes loss due to theft or misappropriation more difficult to detect. Adjustments to inventory balances should be made rarely, and only after proper investigation and adequate justification. The HRA practice of routinely adjusting inventory balances reveals a serious control weakness in that there is no way to determine whether inventory is being stolen or misplaced.

### **Inventory Counting Methodology Does Not Follow DOI Standards**

HRA does not follow DOI standards when conducting a physical inventory count. This is because of HRA management's failure to implement good controls over its inventory operations. As a result, the agency has no control to ensure the accuracy of its perpetual inventory records and to ensure that goods are not being misappropriated or lost.

DOI standards state that a physical count should be performed at least once a year to ensure that the perpetual inventory records are accurate. Regarding the counts, DOI requires that a number of steps be performed, including but not limited to the following:

- Close the warehouse to allow for a reliable, accurate, and complete count.
- Include all stored goods and all inventory locations in the physical inventory.
- Perform a "double, blind count." All items should be counted twice and the recount should not be conducted by the individual(s) who made the initial count.
- Personnel responsible for a storage location should not be assigned to that area for the physical count.
- Discrepancies between the perpetual inventory and physical inventory should be investigated. Auditors, or those independent from the inventory operations, should investigate discrepancies before submitting reconciliation adjustment to management for approval. Reports of significant differences should be forwarded to DOI.

To determine whether HRA follows DOI standards for performing an annual inventory, we observed HRA warehouse personnel and HRA auditors perform two separate counts on April 24, 2002, and May 8, 2002. We saw numerous deficiencies in HRA's administration of the count.

First, HRA failed to ensure that it closed the warehouse during the count. HRA conducted its count over a four-month period, April through July 2002. HRA personnel were able to receive inventory items while the count was being conducted. As a result, HRA had to make numerous adjustments to its count results based on the extra activity, thus increasing the risk of errors in its count results and calling the reliability of the count into question.

Second, HRA did not include all goods in its count. HRA stores all returned goods in a large room in the warehouse, and these items were not counted. Moreover, HRA has no systematic method to ensure that all items are counted. HRA's failure to ensure that all items are included in the inventory count results in an incomplete accounting of everything that is in stock.

Third, HRA failed to use the double blind count. HRA employed three two-person teams to count the inventory items; however, the methods the teams used were neither consistent nor in accordance with DOI standards. When we spoke with counters, they either did not know what a double blind count was, or said that if they tried to do one, they would never complete the count. Accordingly, the counts were never corroborated.

Fourth, HRA failed to ensure that personnel were prohibited from conducting a count in the area to which they were regularly assigned. Therefore, workers would have the opportunity to cover up any misappropriation of items that they oversee in the course of their regular duties.

Finally, discrepancies between the perpetual inventory records and physical inventory on hand were not investigated. As stated previously, the warehouse supervisor merely adjusted the perpetual records to reconcile with the count results. (At one point she stated that the counters are sometimes inaccurate. This weakness would be addressed if HRA employed a double blind count, as required by DOI.) As a result, HRA has no controls in place to determine the reasons for discrepancies so it can take corrective action to minimize their occurrence.

### **Inadequate Controls over Safeguarding Inventory**

In addition to the weaknesses in HRA record-keeping, the agency has inadequate controls to safeguard the inventory. Non-warehouse personnel are allowed in storage areas, returned items are not returned to inventory promptly, and video surveillance equipment is insufficiently maintained. Finally, HRA has taken no measures to ensure that all personnel take annual leave. The result is a greatly increased risk that inventory will be misappropriated or lost.

Security measures are necessary to deter and detect the loss of inventory. The risks from theft and the falsification of inventory records are significantly decreased through the development and implementation of effective security measures. Attachment B, “Requirements for Physical Security” of the DOI standards states that:

“premises are protected by security devices (e.g., fences, guards, lighting, alarms, video and motion surveillance equipment) to prevent the unauthorized removal of goods and records and the entrance and exit of unauthorized persons. Items of significant value, susceptible to theft, are stored in restricted, secure areas; only designated employees should be allowed to enter this restricted area. In addition, a separate log should be maintained that records all incoming and outgoing shipments from these areas. Item counts should be conducted to verify the accuracy of the log.”

The HRA Office of Facilities Operations (OFO) has a Building Safety and Inventory Control Unit (BSIC) that is responsible for security at the warehouse. This unit checks materials brought into and taken out of the building by trades staff and maintains a video surveillance system. To determine whether there was adequate security measurements at the warehouse, we performed a walkthrough of the warehouse area, interviewed the security personnel, and

reviewed video surveillance tapes and log records. Overall, we found numerous deficiencies in HRA efforts to safeguard its inventory.

While performing a physical inspection of the premises in February 2002, we noticed that some large materials (drywall, piping, etc.) were stored outside the warehouse in a garage area behind unlocked gates. We noted security cameras throughout the warehouse and garage area, and security personnel told us that the warehouse and garage are videotaped continuously. However, when we visited the security office to view the tapes, we discovered that the garage and warehouse were not being videotaped at the time of our visit. We observed tapes stored on shelves, most of which were undated. No tapes were dated later than 1997, nor did HRA maintain a log recording the stored tapes. The head of security told us he has “everything in his head.” He also said that it was unnecessary to label anything because he takes no time off. (This issue is discussed later in this section.) However, when we asked to review the most recent videotape, he provided us with one from March 2002—four months earlier.

We also found that non-warehouse personnel are allowed in the storage areas. DOI standards require that only authorized personnel should be allowed in the warehouse area. Nevertheless, HRA warehouse personnel told us that HRA Construction Division employees are granted access to the warehouse by the security personnel during hours that the warehouse is closed (including weekends) for “emergency purposes,” under authorization by the Deputy Commissioner with authority over tradespeople. When inventory is removed at these times, the warehouse supervisor and the former director stated that there is not an accurate record of the items taken. In addition, we observed that warehouse staff allowed non-warehouse personnel in the storage areas. For example, on one occasion a tradesperson came to the warehouse to obtain an item and a warehouse employee permitted the person to retrieve the item himself stating, “You know where it is.”

HRA also does not properly account for all items it receives. When tradespeople return items, they submit no paperwork indicating what is being returned, nor does anyone from the warehouse area prepare a receiving report indicating what was returned. These returns are counted or reentered in the inventory only during slow periods. According to the warehouse supervisor, warehouse staff workers are sent to sort through the “returned items when they have time.” Reusable items are entered in the system as “adjustments.”

### **BSIC Director Does Not Take Annual Leave**

The BSIC director at the warehouse did not take any days off during the period January 2000 through July 19, 2002. HRA’s failure to require that its head of warehouse security take days off, as required by DOI standards, is a control weakness that prevents the agency from determining whether the director is fulfilling his responsibility to safeguard the agency’s inventory in an appropriate manner.

DOI Standard #3, concerning establishing and enforcement for all staff a specified limit of responsibility, states that “all employees involved in the inventory processes, managers, supervisors and staff, take annual vacations of at least five to seven consecutive business days. The use of replacement personnel while an employee is on vacation is a good opportunity to help

determine, among other things, if the employee has been functioning properly and within the specified limits of responsibility.”

During our discussion with the director, he told us that he does not take any time off. To determine whether HRA followed DOI guidelines regarding employees taking leave, we reviewed the personnel time records of all the warehouse staff and BSIC staff at the warehouse for 1999 through July 2002. We found that almost every employee had taken at least five days of annual leave each year. But the director had taken a total of 18 hours and 53 minutes of annual leave in two-and-a-half years (January 2000 through July 2002). At no time during this period did he take a full day off. A breakdown is shown below.

Annual Leave:

2000—18 hours, 23 minutes (a full day of leave was not used during the year)

2001—30 minutes (during January 2001)

2002—0 up to July 19, 2002

Please note that we found no evidence of any impropriety on the part of the director. Nevertheless, considering the severity of the weaknesses we identified in regard to security over the warehouse, we believe that HRA should take steps to enforce all of DOI standards related to safeguarding inventory, including the leave time provision for employees involved in its inventory operations.

### **Computerized Inventory System Malfunctions**

In addition to HRA’s numerous control weaknesses, the computer system it uses to record inventory is faulty, further weakening HRA’s controls over inventory and making it more difficult to identify loss or misappropriation of inventory.

DOI Standard #8 states that the records must present a complete picture of all transactions. In addition, Standard #24, states: “the agency maintains within the Control unit a single, safeguarded and complete set of accounting records that accurately record all additions to, and depletions from, the inventory.”

HRA uses the Assetworks computer program to record its inventory. According to the former warehouse director, the system was designed for colleges and universities. Assetworks has a number of functions, including inventory management. However, based on discussions with the warehouse supervisor, it appears that the system is not suitable to meet the needs of warehouse personnel for managing its inventory.

Assetworks does not allow warehouse personnel to accurately document transfers from one bin to another; the system does not always make offsetting entries when items are transferred to other locations in the warehouse. Thus, items are sometimes counted twice. For example, we observed the supervisor attempting to transfer 277 units of inventory item #5009002271 from one bin to three other bins. However, the system failed to remove the items from the original bin, resulting in the items being counted twice, as shown in Table IV below.

**Table IV**

Assetworks Report of Transfer of 277 Units of Inventory

Bin	Unit Balance Before Transfer	Actual Unit Balance after Transfer	Unit Balance Reported by Assetworks After Transfer
BB001_001	277	0	277
BB020_001	0	100	100
BB021_001	0	100	100
BB022_001	0	77	77
Totals	277	277	554

Since the September 11, 2001, attack, when it lost its main communication link, the warehouse has had numerous power outages resulting in the system failure of Assetworks. However, the system does not allow persons to record actual transaction dates (date released, date of receipt, etc.), if they differ from the date that the data was entered. As a result, the system does not provide a true picture of inventory activity and hinders the agency’s ability to determine rates of use.

At the exit conference, HRA officials disagreed with this finding and contended that we would have obtained more accurate information on the system’s capabilities had we directed our inquiries to the OFMS Information Systems Support Unit, which is responsible for maintaining Assetworks. However, our inquiries were not technical but operational; our intent was to determine how warehouse personnel used the system in managing its inventory. Therefore, our inquiries were directed to persons who actually used the system. Officials further contended that, except for some minor issues, Assetworks is able to meet the agency’s needs. However, it appears that this view is not shared by the warehouse personnel we interviewed, who during the course of this audit contended—and demonstrated—that the system is not working as intended at the warehouse.

**Agency Comment:** “We disagree with this finding. While problems with average cost calculations were experienced previously, this was due to vendor support being withheld until a maintenance contract was in place. The comment from warehouse personnel that Assetworks was designed for ‘colleges and universities’ is untrue. Assetworks provides the necessary functionality to manage warehouse inventory transactions properly and on a timely basis. . . .We believe that the inadequacies described in the report are not system problems at all, but the result of human error. Therefore, we are scheduling classes to retrain warehouse staff on all Assetworks Inventory Management functions, so that the inventory management tools available in the system can be properly utilized.”

**Auditor Comment:** We agree that for any system to run properly a current maintenance agreement must be in place. However, when employees who use the system cannot properly use it to perform everyday functions, as was the case for warehouse staff

during the course of our audit, the system is rendered useless. Accordingly, we commend HRA on its decision to ensure that warehouse staff are properly trained to use Assetworks.

## **Conclusion**

HRA inventory operations are severely mismanaged and in need of a complete overhaul. HRA has serious weaknesses in terms of keeping accurate records and maintaining adequate controls over the issuance and safeguarding of inventory.

We believe that the deficiencies in HRA's inventory operations are primarily caused by HRA management's failure to provide warehouse personnel with clear guidelines and direction so that they can properly manage the agency's inventory. The risks associated with not having clear written guidelines for inventory management are identified by DOI in its standards. Standard #6 states, in part:

“The absence of clearly written policies and procedures that define limits of authority can result in staff being allowed excessive discretion that can provide opportunities for undetected thefts and other dishonest activities. Lack of procedures renders it more difficult to hold individuals accountable for their actions or failure to act.”

Based on our observation of HRA inventory operations, it appears that an environment exists whereby it would be difficult, if not impossible, to detect misappropriation of inventory. Discrepancies between physical counts and inventory records are not referred for investigation by HRA management. In fact, HRA management assigned the same people responsible for receiving and distributing inventory to conduct the inventory counts, and records are adjusted based on their count results, with no subsequent investigation of discrepancies.

According to warehouse personnel, HRA's computerized inventory system is not equipped to meet the needs at the warehouse and hinders the agency's ability to properly manage its inventory. However, we contend that the numerous weaknesses in HRA's management of inventory are not primarily caused by the computer system. Rather, they are due to staff's lack of training or knowledge of basic inventory controls and procedures. Under these circumstances, a new computer system would have little impact on the problems we identified.

Normally, we would recommend a series of actions to HRA designed to address the problems we identified. However, the management and operational problems are so pervasive throughout the agency's inventory system that they cannot be readily addressed by fine-tuning the system. The entire system must be overhauled.

Because of the serious issues discussed in this report, we will be forwarding a copy to DOI for further investigation as warranted.

## **Recommendations**

Given the scope of the work that needs to be done, we recommend that HRA:

1. Create an inventory project team that reports to the Commissioner or a high-level Deputy Commissioner, whose function would be to overhaul and redesign the agency's inventory system. In re-engineering the system, this team should incorporate the inventory standards encompassed in the DOI "Standards for Inventory Control and Management" and in Comptroller's Directive #1.

***Agency Response:*** "We agree with this recommendation. Under the direction of the GSS [Office of General Support Services] Deputy Commissioner, several corrective actions have already been implemented, and representatives from the Agency's Bureau of Internal Audit with knowledge of inventory management and DOI standards will be included in this process."

2. As an alternative, if HRA does not think that it has the in-house skills necessary for an inventory re-engineering project, we recommend that HRA seek funding to hire an outside consultant to address the problems and use the future savings from its inventory operations to pay for the consultant.



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W-1  
Rev. 5/02

VERNA EGGLESTON  
*Administrator/Commissioner*

May 13, 2003

Mr. Greg Brooks  
Deputy Comptroller  
Policy, Audit, Accountancy & Contracts  
The City of New York  
Office of the Comptroller  
1 Centre Street – Room 530  
New York, NY 10007-2341

Re: Audit on the Internal Controls of the  
Human Resources Administration Over Its  
Warehouse Inventory  
Audit # MJ02-145A

Dear Mr. Brooks:

Thank you for the opportunity to respond to the draft report on the referenced review. The report has assisted us in our ongoing efforts to improve the operations of our agency.

The following are our specific responses to the audit's findings and recommendations:

**Comments On The Introduction**

- Since 1998, there has been a tremendous reduction of inventory maintained in the Agency's General Support Services (GSS) warehouse, from 16,000 commodities valued at \$6 million, to 4,500 commodities valued at less than \$1.1 million. This addressed a finding in past audits of the warehouse. Working with GSS/Office of Facilities Operations (OFO), which manages the trade shop areas, GSS/Office of Facilities Management Services will continue to relinquish trade supplies and equipment maintained in the warehouse to the greatest extent possible, to reduce the number of commodities maintained and associated costs.
- The warehouse currently does not have a manager. We will seek to fill this position, and will also seek to replace tradestaff currently assigned to the warehouse with staff in more appropriate titles, such as Procurement Analyst and Stockworker, Levels I and II.

**Auditors' Finding: Inventory Management Problems - HRA management failed to institute proper controls over its inventory operations. (p. 5)**

**Agency's Response:** We agree that improvements are needed, and GSS will implement the corrective actions indicated in response to the specific issues cited below.

**Auditors' Finding: HRA Management failed in its responsibility to provide clear direction to its staff in the form of written policies and procedures... (p. 6)**

**Agency's Response:** We agree that written policies and procedures are needed. A Work Flow Process/Procedure is being developed by OFMS specifying proper warehouse operations. The document will comply with all DOI standards, and will include four distinct units for the specific warehouse functions of a Receiving Unit, a Storage Unit, a Distribution Unit, and a Control, Accounting and Analysis Unit. The warehouse manager will be held responsible for compliance of all warehouse staff with this new procedures, which will be completed by July 2003.

**Auditors' Finding: Inaccurate Inventory Records - 21 Percent Gross Discrepancy between Amounts on Hand and Amounts Reported in Records. (p. 7)**

**Agency's Response:** We agree that there was a 21 percent gross discrepancy rate with regard to sampled items. However, the Assetworks system is capable of maintaining accurate and detailed inventory records when used correctly and to its full capacity. To ensure that the system will be used to its full potential, all warehouse staff will be retrained in all functions related to warehouse operations and inventory management.

Regarding the unit-counting error that led to the overstatement of inventory by approximately \$2 million, this error was identified by the Agency in June, 2002, and an appropriate adjustment was made by warehouse staff. A Variance Justification Form was completed and is on file.

Additionally, OFMS management will order unscheduled and unannounced physical inventory counts of commodities maintained in the warehouse. Results of such counts will be compared with existing inventory records maintained in Assetworks, and differences between the inventory on hand and perpetual records will be investigated, with those that remain unreconciled being reported to the Inspector General. These counts will help ensure the integrity of warehouse operations. In addition, a monthly report of inventory value will be provided to OFMS management for review.

**Auditors' Finding: Improper Adjustments to Inventory Balances. (p. 8)**

**Agency's Response:** We partially agree with the finding. Adjustments to inventory balances are generally investigated and documented on a Variance Justification Form, with hard copies maintained at the warehouse. However, to date, justifications for variances have not been entered into the Inventory Management Module of Assetworks. GSS/OFMS warehouse staff will be trained to enter a comment onto the Inventory Adjustment screen whenever an adjustment is made in Assetworks, so that each adjustment will have a clear explanation.

Concerning 27 adjustments made for return of unused materials (p. 9), the report states that these “generally represented returns from job sites delivered *by contractors hired by HRA to return unused inventory to the warehouse*” [italics added]. This statement is erroneous. The returns are made by GSS/OFO trade staff – Agency personnel – not by contractors. This issue has been raised with the auditors previously, and we again request that it be corrected.

**Auditors’ Finding: Inventory Count Does Not Follow DOI Standards. (p. 10)**

**Agency’s Response:** We agree with this finding. The new Workflow Process/Procedure will comply with DOI Standards concerning counting methodology. For the next planned inventory count, scheduled for June 2003, we will close the warehouse for approximately two and a half weeks. Warehouse staff will conduct a double-blind count of all commodities, and efforts will be made to ensure that no warehouse staff perform counts in areas where they are normally assigned. All stored goods and all inventory locations will be included in the physical inventory, and any discrepancies between perpetual and physical inventory records will be investigated, with significant differences forwarded to DOI.

**Auditors’ Finding: Inadequate Controls Over Safeguarding Inventory. (p. 11)**

**Agency’s Response:** We partially agree with this finding.

- Only warehouse staff are granted access to the warehouse area: any deviation from this policy was an exception. This policy will be reinforced with warehouse and trade personnel, who will be advised that disciplinary and/or other corrective action will be taken if this policy is violated. The only authorized exception will relate to large and/or heavy supply/equipment requests, at which times tradespersons will be escorted by a warehouse staff member, to assist in carrying the items out.
- OFMS has received an estimate for the installation of a new security system for the warehouse, the staging area and the bay/return area as well as all exits/entrances to the location, and will continue planning its implementation.
- The existing CCTV system used to monitor the warehouse is operational and will remain in use until a new system is implemented. Also, a log book has been developed to track and account for all used videotapes. Each tape covers a 72-hour period, and all tapes will be maintained for a period of 42 days.
- The tape used for the camera focused on the OFO Return Area in the garage at 260 11<sup>th</sup> Avenue will be monitored by the warehouse staff. The other three videotapes, which monitor the entrances/exits to the warehouse, will be monitored by the OFO/Bureau of Safety and Vehicle Control (BSVC) Desk, which is responsible for monitoring the movement of vehicles into and out of the bay area. This alternative monitoring method will serve to enhance the integrity of the video monitoring system.
- Keypad locking devices have been installed at all doors leading into the warehouse area, replacing the existing keys. The code for entry into the Warehouse will only be known to the

warehouse supervisor and alternate, the Assistant Deputy Commissioner/OFMS and alternate, and the Assistant Deputy Commissioner/OFO and alternate.

- For building emergencies during off-hours (evenings and weekends), the assigned OFO tradeperson will be required to contact one of the above listed individuals, through the BSVC 24-hour desk, for access into the warehouse to retrieve supplies/equipment needed to respond to the emergency situation. The following business day, the keypad combination will be changed in order to preserve the integrity of the locking devices. Once again, only those staff members listed above will be provided with the new keypad combination.
- A 10-foot gate has been installed in the bay area at 260 11<sup>th</sup> Avenue in order to secure some large items (e.g., piping) that do not fit in the elevator to be brought into the warehouse proper. The key to this gated area will be maintained by the GSS warehouse Supervisor and alternate. This area will be under the strict control of the OFMS/Central Stockroom.
- OFO will ensure that all unused supplies/equipment returned by the OFO tradeperson is accompanied by a work request, so that the unused inventory is returned to the proper bin and an adjustment made in the inventory count. The key to this gated area will be maintained by the BSVC 24-hour desk. This area will be under the strict control of OFO.
- OFO management will require that all requests for supplies/equipment from the warehouse must be submitted by 12:00 noon for pick up the following morning. This will preclude the entry of non-warehouse personnel into the facilities during off hours. Only in the case of documented emergencies will supplies be issued the same day. A written procedure addressing this new policy will be issued to all trade shop personnel.

**Auditors' Finding: BSVC Director Does Not Take The Required Amount of Annual Leave. (p. 13)**

**Agency's Response:** We agree with this finding. The person referred to is neither a "Director" nor a "security officer." He is the Supervisor of BSVC, a unit under the purview of OFO that is responsible for (among other tasks) overseeing the operation of the garage and bay areas at 260 11<sup>th</sup> Avenue. However, OFO management will ensure that this employee does take at least two weeks of annual leave per year. (This employee did take seven annual leave days during the period April 21, 2003 to May 2, 2003, see Attachment A). All other warehouse staff in sensitive positions will also be required to take annual leave on a regular basis.

**Auditors' Finding: Computerized Inventory System Malfunctions. (p. 13)**

**Agency's Response:** We disagree with this finding.

- While problems with average cost calculations were experienced previously, this was due to vendor support being withheld until a maintenance contract was in place. The comment from

warehouse personnel that Assetworks was designed for "colleges and universities" is untrue. Assetworks provides the necessary functionality to manage warehouse inventory transactions properly and on a timely basis.

- Following release of the preliminary audit report, the Assetworks Inventory Management functions were re-tested by OFMS Information Systems and Support Unit (ISSU) and were found to be working properly. We believe the inadequacies described in the report are not system problems at all, but the result of human error. Therefore, we are scheduling classes to retrain warehouse staff on all Assetworks Inventory Management functions, so that the inventory management tools available in the system can be properly utilized.
- Assetworks does provide information on all transactions applied, and it includes reporting capabilities on usage, minimum, maximum, and re-order points for warehouse inventory items. Warehouse staff are currently reviewing all trade supply and equipment usage for the past two years in order to identify appropriate minimums, maximums, and reorder points for items maintained in warehouse inventory. This information will be entered into Assetworks.

**Auditors' Recommendation: Create an inventory project team that reports to the Commissioner or a high-level Deputy Commissioner, whose function would be to overhaul and redesign the agency's inventory system. In re-engineering the system, this team should incorporate the inventory standards encompassed in the DOI "Standards for Inventory Control and Management" and in Comptroller's Directive #1.**

**Agency's Response:** We agree with this recommendation. Under the direction of the GSS Deputy Commissioner, several corrective actions have already been implemented, and representatives from the Agency's Bureau of Internal Audit with knowledge of inventory management and DOI standards will be included in this process.

Again, thank you for the opportunity to respond to the audit and we trust that this response will be included in the final report. We believe that the corrective actions outlined above will address the findings and recommendations identified by the auditors.

Should you have any questions or concerns, please contact Hope Henderson, Director of the Bureau of Audit Coordination (212/331-3522).

Sincerely,

  
Sandra Graves-Morgan  
Executive Deputy Commissioner

  
Frances Abbadessa  
Executive Deputy Commissioner

ATTACHMENT A

KTPRC471 Employee Weekly Time Approvals R4711 9.3.8.4  
 Employee: DONATO, ANTHONY Week Ending: 04/26/2003  
 STRAIGHT 35 HRS MON-FRI 1/2 HR LUNCH Lunch Allowance: 00:30

	In	Out	Elapsed Time	Status
SUN	[ : ] [04/20/2003]	[ : ] [04/20/2003]		APP
MON	[ : ] [04/21/2003]	[ : ] [04/21/2003]		APP
TUE	[07:53] [04/22/2003]	[15:36] [04/22/2003]	07:43	APP
WED	[ : ] [04/23/2003]	[ : ] [04/23/2003]		APP
THU	[07:36] [04/24/2003]	[15:44] [04/24/2003]	08:08	APP
FRI	[07:27] [04/25/2003]	[15:41] [04/25/2003]	08:14	APP
SAT	[ : ] [04/26/2003]	[ : ] [04/26/2003]		APP

Week Approved by [SANTINO, JOSEPH] on [04/26/2003 07:26].  
 P1=EXIT 2 3MultipleTrade 5 5 7Detail 8 Help

RTPR347- Employee Weekly Time Approvals 114711 9.3.3.4

Employee: DOMAYO, ANTECITY Week Ending: 05/03/2003

STRAIGHT 3E HRS MON-FRI 1/2 HR LUNCH Lunch Allowance: 00:30

	In	Out	Elapsed Time	Status
SUN	[ : ] [04/27/2003]	[ : ] [04/27/2003]		
MON	[ : ] [04/28/2003]	[ : ] [04/28/2003]		APP
TUE	[ : ] [04/29/2003]	[ : ] [04/29/2003]		APP
WED	[ : ] [04/30/2003]	[ : ] [04/30/2003]		APP
THU	[ : ] [05/01/2003]	[ : ] [05/01/2003]		APP
FRI	[ : ] [05/02/2003]	[ : ] [05/02/2003]		APP
SAT	[ : ] [05/03/2003]	[ : ] [05/03/2003]		APP

Week Approved by: (SPAWINO, JCSEPH) on (05/05/2003 07:16)  
 PI-EXIT 2 MultipleTrade 5 6 Detail 8 Help