

**Personnel Department  
Pharmacy Inventory  
Audit 11-01  
May 27, 2011**



# City of Chattanooga

INTERNAL AUDIT

City Hall

Chattanooga, Tennessee 37402

Stan Sewell  
Director

Ron Littlefield  
Mayor

June 29, 2011

Mayor and City Council  
City of Chattanooga  
Chattanooga, TN 37402

RE: Pharmacy Inventory Audit 11-01

Dear Mayor Littlefield and City Council Members:

Attached is the Internal Audit Division's report on Pharmacy Inventory.

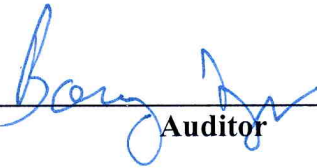
We thank the management and staff of The Benefit Advocate, the City Personnel Department and the City Finance Department for their cooperation and assistance during this audit.

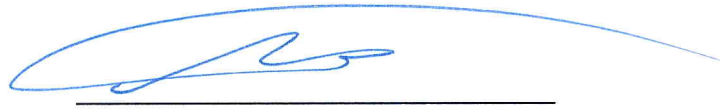
Very truly yours,

Stan Sewell, CPA, CGFM  
Director of Internal Audit

cc: Dan Johnson, Chief of Staff  
Donna Kelley, Personnel Administrator  
Daisy Madison, Chief Financial Officer  
Audit Committee Members

**Personnel Department  
Pharmacy Inventory  
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\_\_\_\_\_  
**Auditor**

  
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**Director**

# **PERSONNEL DEPARTMENT PHARMACY INVENTORY AUDIT 11-01**

## **INTRODUCTION**

The City of Chattanooga contracted with The Benefit Advocate and CareHere, Inc. to provide on-site pharmacy management, pharmacists and onsite pharmacy services to City employees, retirees and their dependents who are enrolled in the City's health insurance plan or eligible under Employer's occupational coverage. The City is to pay a management fee of \$8.76 per subscriber per month for these services. CareHere was relieved of responsibility related to the pharmacy in May 2010, with The Benefit Advocate assuming management of all phases of the City pharmacy operations (Well Advantage Pharmacy), procuring and providing pharmaceutical drugs and over the counter medicine at a pass through cost (no profit) from their suppliers. The Benefit Advocate guarantees the average wholesale costs of product will be greater than the costs of drugs, labor and management fees paid by the City, as compared quarterly. If the quarterly costs to the City are greater than the average wholesale costs would be, The Benefit Advocate agrees to pay a fine of \$25,000. Benefit Advocate is responsible for maintaining a perpetual inventory system with reorder points, value of inventory, etc. The City is responsible for providing accounting systems for the collection of cash, credit, etc.

## **STATISTICS**

For the period December 2008 through December 2010 the City has paid The Benefit Advocate \$7,234,000 for drug and pharmacy products.

## **STATEMENT OF OBJECTIVES**

This audit was conducted in accordance with the Internal Audit Division's 2011 Audit Agenda. The objectives of this audit were to determine if:

1. Invoicing for drugs from The Benefit Advocate to the City is a pass-through of billings from their supplier (McKesson Pharmaceuticals).
2. The City invoice approval and payment process is adequate.
3. A perpetual inventory system is in place and functional per contract terms.

## **STATEMENT OF SCOPE**

Based on the work performed during the preliminary survey and the assessment of risk, the audit period covers internal City processes and invoices of The Benefit Advocate from December 2008 to December 2010.

## **STATEMENT OF METHODOLOGY**

We reviewed the contract between The Benefit Advocate and the City for pertinent facts related to our audit. We met with personnel of The Benefit Advocate, the City Pharmacy and the City Personnel Department to discuss operations. We obtained records related to payments to The Benefit Advocate from the City Finance Department to determine if proper procedures were followed for payments related to the pharmacy contract. We obtained packing slips from the City Pharmacy to ensure statements paid matched product received. We obtained reports from Personnel to determine if agreed upon reporting was produced. We interviewed employees of the Personnel Department to determine if procedures were in place related to tracking compliance with the contracts, and, if so, were being followed.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in City financial systems. The City's financial system was previously determined to be reliable and no additional work was necessary.

## **STATEMENT OF AUDITING STANDARDS**

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## **AUDIT CONCLUSIONS**

Based upon the test work performed and the audit findings noted below, we conclude:

1. Invoices from The Benefit Advocate to the City were passed on with no markup from the suppliers of The Benefit Advocate: Innoviant and McKesson Pharmaceuticals.
2. The City invoice approval process is not adequate to ensure proper amounts are paid to the supplier.
3. The Benefit Advocate does not have a perpetual inventory system in place as required by the contract terms.

## **NOTEWORTHY ACCOMPLISHMENTS**

Operation of the pharmacy has reduced the City's total expenditures on employee healthcare, while also reducing out of pocket expenses of City employees, employee dependents and retirees. Overall usage of the employee pharmacy has risen to approximately 65% of total prescriptions filled from program inception in January 2009 through December 2010.

## **INVOICE APPROVAL METHODOLOGY**

During a review of the methodology for approving payment of statements received from The Benefit Advocate by the Personnel Department we found a statement is e-mailed to the City twice monthly, along with a spreadsheet detailing information contained on the statement. The statement total is matched to the total of the spreadsheet before approval. No steps are taken to ensure billings match what has been received, such as matching product quantities on daily packing slips to the statement. *The Internal Control and Compliance Manual for Tennessee Municipalities* Title 5, Chapter 19, Section 2 states, in part: Municipal officials should ensure that the request for payment (statement) from the vendor is compared to the individual invoices on file. Payment should never be based on a statement only. The testing of prices, extension of amounts, and addition of the total invoice should be required.

We also found that approval for payment of these statements is sometimes received in accounts payable prior to completion of checking of the invoice totals vs. the spreadsheet. This also is not in compliance with *The Internal Control and Compliance Manual for Tennessee Municipalities* Title 5, Chapter 19, Section 2 which states, in part: Municipal officials should ensure that the request for payment (statement) from the vendor is compared to the individual invoices on file.

### **RECOMMENDATION 1**

We recommend the Personnel Department ensure items listed on the packing slips (approved by the Pharmacist as received) are matched to the semi-monthly statements prior to approving the statement for payment. Two appropriate methodologies would be checking individual items on packing slips to the statement, or reconciliation of a summary of packing slip receipts to the statement total.

### **AUDITEE RESPONSE**

The Personnel Department will develop a strategy to review the packing slips on a routine basis to ensure that statements and shipping materials are matched.

### **RECOMMENDATION 2**

We recommend the Personnel Department ensure all confirmation procedures on drug statements is complete and totals are accurate prior to sending approval to pay to the Finance Department.

### **AUDITEE RESPONSE**

The Personnel Department will comply with this recommendation.

### **PERPETUAL INVENTORY SYSTEM NOT IN PLACE**

During discussions with the Well Advantage Pharmacist it was discovered a perpetual inventory system was not in place, nor had any been used over the course of the contract between the City and The Benefit Advocate, a violation of contract section 1.04. There are currently two inventory systems in place, one tracking receipts and another tracking disbursements. Reorder points are currently managed by use of manual lists. Lack of a perpetual inventory system has caused the City to incur greater handling costs for drug products than necessary. Excess drugs ordered may be returned up to one year after purchase. The pharmacist stated when she arrived (less than one year ago) there was a quantity of excess inventory on hand that could not be returned to the vendor due to age. An efficient perpetual inventory system would have prevented ordering excess product. Further, with excess product identified via perpetual inventory system reports, the product could have been returned to the vendor. Improper inventory levels result in reduced funds invested and investment returns for the City, as well as spoilage of old inventory. Lack of an operational perpetual inventory system also affects internal controls due to the lack of ability to quickly determine unexplained shortages of drugs on hand in case of employee malfeasance.

### **RECOMMENDATION 3**

We recommend the City Personnel Department take appropriate steps to ensure The Benefit Advocate implements a perpetual inventory system as required by the contract as soon as possible.

### **AUDITEE RESPONSE**

The Personnel Department will work with The Benefit Advocate to implement a perpetual inventory system as soon as possible.

### **CONTRACTUALLY REQUIRED REPORTING**

During our review of the contract between The Benefit Advocate and the City we found section 1.10(b) states: The Benefit Advocate represents that the sum of the net cost of drugs supplied through the on-site pharmacy, monthly management fees and quarterly labor costs as set out in this contract will be less than the equivalent average wholesale price for the same drugs in retail and mail network. If the Benefit Advocate fails to meet the requirements of this section for each quarter, it will pay a penalty of \$25,000.

During our review of the contract between The Benefit Advocate and the City we found section 2.14, addressing quarterly reports, was not being followed entirely. The section, among other things, requires reporting related to costs versus benchmarks, trend data and comparison of average wholesale price in retail and mail network versus The Benefit Advocate pricing. These reports are not found in the quarterly reports of December 2010. Section 2.14 also states the City can ask for four ad hoc reports at no charge. The City currently has asked for none.

The Benefit Advocate has not provided a schedule showing quarterly results versus average wholesale price during the audit period, nor have City personnel requested production of proof the savings requirement has been met. Due to the failure of The Benefit Advocate to produce a report, as well as a failure by the City to demand such a report be produced, no means is available to determine whether The Benefit Advocate has fulfilled the requirements of contract section 1.10(b). At the request of Internal Audit, The Benefit Advocate produced a report showing the requirement has been met since contract inception.

**RECOMMENDATION 4**

We recommend the City work with personnel of The Benefit Advocate to receive proper reporting for the remainder of the contract per section 1.10(b) of the contract, with payment of penalties if and when appropriate.

**AUDITEE RESPONSE**

The Personnel Department will request from The Benefit Advocate proper reporting as outlined in the contract and will pursue penalty payments if appropriate.

**RECOMMENDATION 5**

We further recommend City personnel charged with managing the pharmacy contract request proper reporting as stated in section 2.14 of the contract between The Benefit Advocate and require this information be provided in a manner that is easily understood. We further recommend the City Personnel department take advantage of the ad hoc reporting available to them to develop reports that help them run the pharmacy in the most efficient manner possible. An example would be reporting that shows projected usage and cost savings versus actual results, enabling the City to better judge what steps need to be taken to further promote use of the City Pharmacy.

**AUDITEE RESPONSE**

The Personnel Department will request from The Benefit Advocate appropriate reporting that will enable the department to have greater understanding of usage, savings, cost comparisons, etc.