

UC MERCED AUDIT AND ADVISORY SERVICES

April 24, 2018

To: Veronica Mendez – Chief Financial and Administrative Officer

Subject: Employee Reimbursements Audit

Ref: Report No. M18A010

UC Merced Internal Audit has completed an audit of reimbursements paid to employees. The audit reviewed reimbursements for travel and entertainment, and general business reimbursements.

We appreciate the assistance we received from Travel Services staff and the campus Tax Analyst during the audit. If you have any questions concerning the report, please do not hesitate to contact me.



Todd Kucker
Director of Internal Audit

Attachment

cc: Senior Vice President and Chief Compliance and Audit Officer Bustamante
Chancellor Leland
Associate Chancellor and Senior Advisor Putney
Assistant Vice Chancellor and Controller Riley
Assistant Controller Groesbeck
Chief Procurement Officer Dubroff

**UNIVERSITY OF CALIFORNIA, MERCED
AUDIT AND ADVISORY SERVICES**

Employee Reimbursements
Report No. M18A010

April 24, 2018

Work completed by:
Brandi Masasso – Internal Auditor

Management Summary

At the request of the Campus Audit committee, UC Merced Internal Audit has completed an audit of employee reimbursements. During the audit, we identified instances where poor review processes resulted in duplicate reimbursements and where documentation did not provide sufficient evidence that expenses were actually incurred by employees. Although there were areas for improvement, in most cases, procedures and controls related to employee reimbursements appeared to be operating effectively.

The following report discusses our observations and recommendations under the following headings:

- Insufficient review processes
- Late reimbursements requests
- Accruing Sales/Use Tax on items purchased via reimbursement

Purpose and Audit Objectives

Internal Audit has completed an audit of employee reimbursements. After identifying potential issues during a cursory review of data analytics, a more in-depth audit was completed at the request of the UC Merced Campus Audit Committee in order to review that employee reimbursements were adequately documented and to ensure compliance with University policies.

The audit objectives were:

- To determine if travel and business expenditure policies and procedures were complied with;
- To verify that travel and business expenses were for official University business; and,
- To verify that travel and business expenses were properly authorized.

Scope of the Audit

The scope of the audit focused on reimbursements paid to employees during fiscal year 2016-2017. It also encompassed discussing current processes and procedures with UC Merced Travel Services.

In performing this audit, we queried all reimbursements paid to employees during fiscal year 2016-2017. A random sample of 70 employees was selected from the employees with the largest total reimbursements during the year. From the remaining population a random sample of 50 additional employees was selected. We excluded Senior Management Group employees from this testing as the Controller's Office has additional review procedures for reimbursements paid to these employees and these reimbursements are included in the annual audit of Executive Compensation.

To fulfill the objectives, we completed the following testing for reimbursements paid to the 120 selected employees:

- Reviewed University policies relevant to travel and business reimbursements;
- Evaluated whether there are adequate controls over the processing of travel and business reimbursements; and,
- Reviewed backup documentation related to the employee reimbursements.

Background

Travel and Entertainment at UC Merced

On a system-wide level, all reimbursements must be properly authorized, reported and reimbursed in accordance with Business and Finance Bulletin (BFB) G-28: *Policy and Regulations Governing Travel* and BFB BUS-79: *Expenditures for Business Meetings, Entertainment, and Other Occasions*. Additionally, UC policies G-28 and BUS-79 both allow campuses to establish more restrictive policies for the reimbursement of expenses. Campus departments may also implement more restrictive policies in these areas.

On a local level, UC Merced’s Travel Services is charged with assisting departments by providing resources for processing travel expense reimbursement requests, managing the Travel Card program, and providing guidance on policy requirements. The responsibility is shared with department supervisors to review, approve, and ensure that travel reimbursements are in compliance with applicable policies.

UC Merced departments utilize an online expense reporting system called UCLA Express to process travel and entertainment reimbursements. Express is designed to allow travelers and proxies to create travel expense reports and route them to the appropriate reviewers before submitting to UCLA for processing. It is the responsibility of an employee traveling on official University business to report their actual expenses in a reasonable and ethical manner, in accordance with the regulations set forth in UC policies G-28 and BUS-79.

During fiscal year 2016-2017, UC Merced incurred more than \$3 million in travel and entertainment expenses. This total includes reimbursements paid with the Travel and Entertainment card. The breakdown of these costs is as follows:

Travel and Entertainment Payments	FY 2014	FY 2015	FY 2016	FY 2017
Paid with T&E Card	\$953,391	\$1,019,825	\$940,711	\$889,790
Reimbursed directly to Employees	<u>\$1,259,145</u>	<u>\$1,673,554</u>	<u>\$1,801,049</u>	<u>\$1,885,063</u>
Total Reimbursements from Express	\$2,212,536	\$2,693,379	\$2,741,760	\$2,774,853
Plane Tickets Purchased through Direct Bill (PTA System)	<u>\$572,083</u>	<u>\$704,348</u>	<u>\$639,156</u>	<u>\$616,803</u>
Total Travel and Entertainment Costs	\$2,784,619	\$3,397,727	\$3,380,916	\$3,391,656

The table shows a steady increase in the travel and entertainment reimbursements paid directly to employees. It appears that an increasing number of travelers are using personal funds for travel and seeking reimbursement rather than utilizing the campus Travel and Entertainment cards.

Other Employee Reimbursements at UC Merced

Under certain circumstances, it might be necessary for an employee to make authorized purchases or incur official business expenses, other than travel and entertainment, using their personal funds. All non-travel reimbursements must be properly authorized, reported and reimbursed in accordance with BFB BUS-43: *Purchases of Goods and Services; Supply Chain Management*.

On a local level, UC Merced’s Central Procurement is charged with assisting campus departments by disseminating and providing guidance to departments on procurement policy requirements and has no role in reviewing and approving expenditures. It is the responsibility of department supervisors to review, approve and ensure that reimbursements are in accordance with the regulations set forth in UC policy BUS-43. UC Merced departments utilize the campus procurement system, CatBuy, to process general reimbursements.

The table below shows reimbursements not related to travel and entertainment that were paid to employees during the last four fiscal years. These reimbursements continue to increase year after year.

	FY 2014	FY 2015	FY 2016	FY 2017
Non T&E Employee Reimbursements	\$333,542	\$360,049	\$400,929	\$505,388
% Annual Increase		8%	11%	26%

Reimbursements to employees are considered an area of fraud risk at universities. Expenditures for travel and entertainment are often discretionary costs and are often poorly controlled and documented.

Every two years, the Association of Certified Fraud Examiners (ACFE) identifies the frequency of fraud schemes by industry. Phony expense reimbursements is always one of the most frequent schemes in Higher Education. The table below shows the ACFE’s results from their 2016 report.

Fraud Scheme	% of fraud identified at Universities
Corruption (Conflicts of Interest)	35%
Billing (e.g. phony vendors)	22%
Non-Cash	19%
Expense Reimbursements	14%

Conclusion

During the audit, we identified instances where poor review processes resulted in duplicate reimbursements and where documentation did not provide sufficient evidence that the expenses were actually incurred by employees. We also noted instances where better planning could have resulted in lower travel costs. Although there were potential areas for improvement, in most cases, procedures and controls related to employee reimbursements appeared to be operating effectively. Based on the results of our testing, we concluded that employee reimbursements were generally in compliance with University policies.

The UC travel policy attempts to balance IRS reporting requirements with cost-effective documentation requirements. As a result, receipts for most expenditures under \$75 are not required to be submitted with a request for reimbursement. This makes it very difficult to verify that the University is only reimbursing for actual costs incurred as travelers are often not required to provide evidence of costs although they consistently request the daily maximum (or near that amount). In essence, the UC system is relying upon travelers to be ethical and abide by a policy which requires reimbursement for actual costs.

During October 2017, based upon a California State Audit recommendation, the daily meal cap for most travel was reduced from \$75 to \$62. If it appears that a traveler is attempting to just be reimbursed for the daily cap, it is the responsibility of the employee approving the travel to make a special request for receipts proving that these costs were actually incurred. This often puts administrative staff in the uncomfortable position of having to be skeptical of faculty, managers, and other employees in authority.

The areas for improvement that we identified are discussed under the following headings:

- Insufficient review processes
- Late reimbursements requests
- Accruing Sales/Use Tax on items purchased via reimbursement

Observations and Recommendations

1. Insufficient review processes

UC Merced relies on campus department supervisors to ensure that internal control processes are operating efficiently by reviewing that employee reimbursements are in compliance with applicable policies. Based upon our review, we identified a number of instances where department supervisors reviewed and approved employee reimbursements based upon insufficient backup documentation. Based upon the documentation provided, we believe that additional receipts and documentation should have been requested from the traveler to verify that the employee actually incurred the costs. The following is a summary of our observations.

- **Per diem cap:** We noted instances where department supervisors approved reimbursements to employees who appeared to be treating the maximum domestic meal

and incidental expenses (M&IE) cap as a per diem. In these instances, there was no evidence that supervisors appropriately followed up for receipts or other evidence that the daily costs were actually incurred.

UC policy G-28 states: “The Meals and Incidental Expenses (M&IE) cap for travel under 30 days shall not be treated as a per diem. M&IE reimbursement shall be limited to the actual reasonable costs incurred; subject to the daily maximum reimbursement cap. Departments should remind their travelers that only expenses actually incurred are reimbursable. Travelers should be required to submit meal receipts if it appears that they are treating the cap as a per diem by routinely claiming the full M&IE amount.”

Additionally, IRS rules and regulations are specific and state that criteria must be in place and must be consistently enforced. If excess per diem payments/reimbursements occurs on a regular basis, those excess payment amounts could be viewed as taxable income to the employee. In extreme circumstances, all per diem payments could be declared taxable income – subject to both income and payroll taxes.

- **Expenses for guests traveling with University employee:** We noted instances where documentation submitted in support of the employee reimbursement did not always provide sufficient evidence that travel expenses did not include costs incurred for individuals traveling with a University employee.

UC policy G-28 states that travel expenses incurred by non-University travelers shall not be reimbursed from a University fund source unless the travel has been approved in advance by the inviting department and serves as a bona fide University business travel purpose.

- **Duplicate reimbursement payments:** We noted an overpayment to a faculty member who received two reimbursements for the same trip. This resulted in an overpayment to the employee of \$2,780. Although the school identified this error on their own, the repayment process from the faculty payment required many months of following up to receive repayment.

We also noted various instances in which a former employee submitted reimbursements for the same transactions and was inappropriately reimbursed. The employee submitted mileage reimbursement requests for the same trips multiple times.

UC Merced relies on supervisors who approve reimbursements to adequately review for, and prevent, duplicate reimbursements.

- **Reimbursed plane tickets:** We noted many plane tickets that were purchased by employees using personal credit cards. There is a fraud risk related to this purchase method as the employee could transfer these plane tickets to a personal airline account. After being reimbursed for the purchase, the traveler could obtain a refund for the ticket or use the ticket for personal travel. When a traveler consistently uses a personal credit card to purchase airline tickets, the supervisor approving travel should be wary and

request additional evidence that these purchased plane tickets were actually utilized by the traveler for the business purpose.

Travel proxies who put together the majority of travel reimbursements at UC Merced are usually in a difficult position to demand additional documentation for travel reimbursements. These administrative employees often report to the travelers and it is uncomfortable for them to require more documentation as it seems like they do not trust the traveler. Lack of appropriate review and follow-up by department supervisors increases the risk of improper costs, duplicate payments, or unauthorized use of University funds and can result in fraud, waste, or abuse.

Recommendation

Internal Audit recommends that supervisors who review and approve reimbursements require that employee reimbursement requests include adequate documentation and all expenses comply with UC policies. Business and Financial Services and Travel Services should remind employees approving travel reimbursements that evidence of expenses incurred is required when it appears that employees may be taking advantage of the daily M&IE cap. The campus could also be served by making improvements through uniform processes, better training and independent reviews which could be achieved through centralization. The current environment (i.e. decentralized) though makes adopting uniform processing and independent reviews nearly impossible to achieve.

Management Corrective Action

Travel Services will update the training they provide to travelers, proxies, and supervisors who approve travel to include the issues identified during the audit. The requirement to follow up for receipts and additional evidence of travel costs when it appears that a traveler might be misusing the M&IE cap will be communicated to employees who set up and approve travel reimbursements.

This action plan will be completed by June 30, 2018.

2. Late reimbursement requests

Background

We noted instances where employees were not timely in submitting expense reimbursement requests. For travel and entertainment reimbursements, BFB G-28 states: “The travel expense claim must be submitted to the disbursements/travel accounting office (or equivalent office on campus) within a reasonable amount of time not to exceed 45 days after the end of a trip unless there is recurrent local travel, in which case claims may be aggregated and submitted monthly. [If a Travel Card is used, campuses have the discretion to require a shorter time frame for submission of the travel expense claim]. When a trip lasts more than 90 days, the traveler must submit a quarterly report of expenditures to the disbursements/travel accounting office. Travel reimbursement requests submitted after 45 days are left to the discretion of the campus,

considering the facts and circumstances, whether the reimbursement will be made and if any reporting as taxable income will be required.”

Observations

We identified an instance where a faculty member submitted more than a year’s worth of travel expenses during June 2017. Costs from multiple trips that took place between May 2016 and early 2017, were submitted late. The \$14,924 worth of past due travel expenses were charged to two NSF awards.

While we verified that the travel costs were allowable and were incurred during the approved time periods of these grants, the untimely submissions of expenses would be a red flag to external auditors. Sponsored Research Services works closely with department research administrators to review that only allowable costs are charged to grants. Their access in the Express system is limited so they do not have easy access to review details of travel costs charged to grants.

Recommendation

As BFB G-28 leaves the discretion of handling late reimbursement requests to the campus, we recommend that a written campus procedure be established which enables the Controller’s Office to take stronger measures to enforce timely submissions. The Controller’s Office should consider whether there is a pattern of late submissions by the employee. The written procedure could provide examples of when travel costs will not be reimbursed for when it will be considered taxable income to the traveler.

We also recommend that employees in Sponsored Research Services be set up with access so they can efficiently review travel reimbursements that are charged to grants.

Management Corrective Action

For the identified instance, because it was a contract and grant and it was allowable, and it’s reimbursed by the granting agency, the Controller’s Office allowed it to go through however, reimbursements older than a year seldom occur. Travel Services analyzed all tickets put through Express over a 22 month period (July 2016 – February 2018) and only 19 tickets took more than a year to submit out of 12,008 tickets for a 0.16% frequency rate. Because of the infrequent nature of the situation, we will continue to monitor and if the issue increases in frequency, we will explore instituting a policy to impute taxes when expenses are not submitted within a reasonable period of time.

Additionally, we will require an exception to policy form be completed if the last travel transaction date is in excess of 45 days from ticket creation in the Express system and will determine an appropriate course of action on a case by case basis. Further, the Organizational Excellence and Sustainability Work Group, a component of the Strategic Workforce Planning initiative has been authorized to explore centralizing travel transaction processing which if approved, the benefits would include 1) emphasize further investment in

travel proxy training and supervision to improve efficiencies in processing, 2) develop better tools and job aids to empower travel proxies and encourage them to exercise professional skepticism, and 3) invest in skill sets to improve policy compliance rates. As part of the process redesign, we would also devote resources to provide more focused training aids to faculty and staff and technology enhancements and automation with business process redesign which can most efficiently be achieved as part of centralization.

3. Accruing Sales/Use Tax on items purchased via reimbursement

Background

Many items purchased from vendors via the internet require purchasers to accrue sales or use tax. At UC Merced, purchasers are responsible for correctly accounting for sales/use tax so the accurate amounts are paid to the California Board of Equalization. Periodically, campuses are audited by Board of Equalization auditors who verify that the correct amounts have been paid. The campus could be at risk of additional payments and fines if the tax is not correctly paid.

Observations

During the audit, we noted various instances where employees purchased items from the internet and were then reimbursed. Per the UC Sales and Use Tax Manual, when the campus reimburses for these items, UC Merced becomes responsible for paying sales/use tax for these internet purchases. In most cases, departments did not identify in Catbuy that sales/use tax should be accrued for these purchases. As a result, the campus has underpaid a few thousand dollars of sales/use tax annually for these purchases.

Recommendation

As these reimbursements to employees continue to increase, it is important that the campus properly capture the sales/use tax for these purchases. We recommend that the campus Tax Manager and the Controller's Office communicate this requirement to department purchasers and Business Officers.

Management Corrective Action

The Tax Manager will continue to train purchasers and Business Officers regarding sales/use tax requirements. She will add the specific requirements related to items purchased via reimbursement to her training materials and will update employees who the requirement will impact.

This action plan will be completed by June 30, 2018.