



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

August 2, 2020

To: Michael Riley – Interim Vice Chancellor and Chief Financial and Administrative Officer
Subject: UC FY20 Fair Wage/Fair Work Plan Audit
Ref: Report No. M20A006

Internal Audit completed the audit of UC Merced's compliance with the UC Fair Wage/Fair Work (FW/FW) Plan requirements as part of the fiscal year (FY) 2019 – 2020 Audit Plan. The systemwide FW/FW Plan requires annual involvement by Internal Audit so this audit is completed at all UC campuses.

Attached is the subject report. This year's audit scope included real estate leases and licenses for the first time since the FW/FW Plan inception. We appreciate the help we received from Procurement and Real Estate Services during this review. If you have any questions, please feel free to contact me.

Respectfully reported,

Sheryl Ireland
Internal Audit Director

cc Senior Vice President and Chief Audit and Compliance Officer Bustamante
Chancellor Muñoz
Associate Chancellor and Chief Ethics and Compliance Officer Putney
Chief Procurement Officer Dubroff
Executive Director Space Strategies and Real Estate Saunders



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**UC Fair Wage/Fair Work Plan Audit
Report No. M20A006**

August 2, 2020

Work completed by:
Sheryl Ireland – Internal Audit Director
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I. MANAGEMENT SUMMARY

Internal Audit completed an audit of UC Merced's compliance with the UC Fair Wage/Fair Work (FW/FW) Plan requirements. To help enforce compliance with the systemwide plan, Internal Audit departments at UC locations were tasked with reviewing their campus Procurement and Real Estate Services management of and compliance with the UC FW/FW Plan requirements. This was the first fiscal year Real Estate Services was included in the annual audit scope since inception of the FW/FW Plan.

Based upon our review of procedures and testing, we concluded that procedures need to be updated in both Real Estate and Procurement Services, and current oversight and reporting processes established by UC Merced Procurement Services need improvement to help ensure supplier compliance with the UC FW/FW Plan requirements. While it is the supplier's responsibility to ensure they meet the requirements of the FW/FW Plan, more rigor and proactive efforts by UC Merced can help improve supplier compliance.

II. BACKGROUND

Procurement Contracts:

On July 22, 2015, University of California President Janet Napolitano announced a new minimum wage plan for University of California (UC) employees titled the "UC Fair Wage/Fair Work Plan." The Fair Wage/Fair Work Plan guaranteed that by October 2017 University of California employees hired to work at least 20 hours a week would be paid at least \$15 per hour.

Outside contractors providing services to the UC are required to pay workers a wage equal to at least the UC minimum wage, upon the renewal of their contract or establishment of a new contract after October 1, 2015. The minimum wage required by the plan is:

- At least \$13 per hour beginning October 1, 2015
- At least \$14 per hour beginning October 1, 2016
- At least \$15 per hour beginning October 1, 2017

The UC created the following mechanisms to ensure contractors comply with this plan:

- Worker hotline – A telephone hotline allows workers employed by UC contractors to report issues related to wages or working conditions.
- Online complaint registration system – An online mechanism for contract workers is available to register complaints directly with the UC.
- Annual and periodic verifications – All UC contractors are subject to an annual verification, paid for by the contractor, to ensure they and their subcontractors comply with the minimum wage plan, as well as all federal, state, and UC workplace laws and policies. UC contractors are also subject to periodic verifications to ensure compliance with the minimum wage rules and expectations for working conditions. The verification requirement must be implemented as existing contracts come up for renewal and as new contracts are established.

For suppliers whose services exceed \$100,000 annually, an annual independent verification must be completed at the supplier's expense. Verifications must be performed by an independent accountant or the supplier's internal auditor (if the internal audit function reports directly to an independent board). The supplier will ensure that their independent accountant or internal auditor:

- Reviews payroll records to confirm Fair Wage/Fair Work compliance.
- Verifies that any complaints submitted by employees were appropriately resolved.
- Makes available Fair Wage/Fair Work verification work papers to UC internal audit upon request.
- Documents any exceptions and management corrective action in verification report.
- Documents verification results on UC Fair Wage/Fair Work verification form and sends to UC (Procurement Services) annually no later than 90 days after each 1-year anniversary of the agreement's effective date.

Real Estate Contracts:

FW/FW Plan requirements for leases and licenses were effective on May 1, 2016. Any lease, license or ground lease that meets the requirements of the plan for which UC had not yet executed a term sheet, memorandum of understanding or letter of intent, or received responses to an RFP was subject to the Plan as of this date. FW/FW Plan compliance requirements are required whether UC is landlord or licensor, or UC is tenant or licensee.

- Requirements: An explicit requirement that the other party (e.g. lessee, licensee, landlord) shall:
 - Comply with the Plan for all of their employees working more than 20 hours per week in premises covered by the applicable agreement,
 - Post a notice in the premises in all break rooms and other public notice areas which notice clearly references the Plan's applicability to the other party's employees, and
 - Provide a certification on an annual basis that they have complied with the Plan as set forth in the first two bullets
- Audit Rights: The applicable agreement shall further include provisions that:
 - Allow UC to audit the other party's compliance with the Plan, and
 - Provides sufficient access to their records for this purpose while providing for appropriate security for such records.

III. PURPOSE, SCOPE AND OBJECTIVES

As part of the Fiscal Year 2019 – 2020 Audit Plan, Internal Audit completed an audit of the UC Fair Wage/Fair Work Plan (FW/FW Plan) at UC Merced. The overall purpose of the audit was to assess compliance with the plan requirements. The audit scope included review of processes, procedures and verification of performance of internal controls and compliance requirements for a sampling of contracts, leases and licenses in place during calendar year 2019.

Our objectives were to:

- Review formal written processes and assess for adequacy;
- Review UC Merced contracts, leases and licenses to ensure that applicable contracts contain the required UC FW/FW Plan provisions;

- Determine whether Procurement and Real Estate Services are reviewing and monitoring contractor compliance with the annual verification requirements where appropriate; and
- Determine if exceptions to the UC FW/FW Plan were properly approved.

To fulfill the objectives, we completed the following testing:

- Reviewed UC policy and other guidance from the UC Office of the President concerning the UC FW/FW Plan;
- Evaluated UC Merced’s processes and procedures to evaluate compliance with requirements;
- Evaluated a sample of applicable real estate leases and a sample of contracts for compliance with the UC FW/FW Plan; and
- Selected and evaluated one supplier that submitted an annual verification form to review and verify that procedures were properly followed.

IV. CONCLUSION

Based on our review of procedures and testing, we concluded that current processes and internal controls managed by UC Merced Procurement and Real Estate Services need improvement in order to ensure supplier compliance with the terms of their agreements. We identified recommendations for improvement in the following areas:

- Real Estate Services written procedures need to be updated and formalized to clarify roles, responsibilities, and key internal controls to ensure compliance with FW/FW requirements related to leases and licenses.
- Procurement Services written procedures need to be updated and formalized to clarify expectations and monitoring processes to ensure supplier compliance with FW/FW requirements related to contracts for services.
- Procurement services needs to Improve monitoring of contracts requiring annual certification and independent verification of supplier compliance with FW/FW Plan requirements.
- Procurement Services needs to continue to ensure its reporting of contracts subject to FW/FW Plan requirements is accurate to facilitate timely audit, monitoring and follow-up as required by the Plan.

Details of observations, recommendations and management corrective actions follow.

V. OBSERVATIONS AND MANAGEMENT CORRECTIVE ACTIONS

1. Real Estate Services written procedures need to be updated and formalized to clarify roles, responsibilities, and key internal controls to ensure compliance with FW/FW requirements related to leases and licenses.

Issue: Real Estate Services was recently reorganized and is working on updating and formalizing its procedures, including those related to the FW/FW Plan requirements. Procedures were drafted during this audit but not yet completed to include roles, responsibilities and compliance oversight of

leases and licenses pertaining to the FW/FW Plan requirements. Real Estate Services can reduce potential risk and improve compliance by completing and formalizing those procedures. Procedures and guidance will help ensure consistency and enhance the process to facilitate and help ensure compliance with the FW/FW Plan as the campus grows and into the future.

Recommendation: Real Estate Services should complete and formalize its procedures to ensure all those involved with ensuring and monitoring compliance with the FW/FW Plan requirements have good reference material and expectations when finalizing agreements for leases and licenses, and a follow-up and escalation process in accordance with the FW/FW Plan when appropriate. Specifically, procedures should identify roles and responsibilities for critical compliance areas for space leases and licenses (where UC is landlord or licensor, or UC is tenant or licensee) and ground leases including:

- When FW/FW provisions should be included
- Exceptions to the plan and approval workflow, including criteria for exceptions
- Compliance requirements including certification follow-up and monitoring when appropriate

Management Corrective Action: UC Merced Real Estate Services is working to complete and formalize procedures and guidance that will help ensure compliance with the UC FW/FW Plan requirements. Procedures will be enhanced to include clarifying roles, responsibilities, approval requirements, monitoring, reporting, follow-up and escalation when noncompliances are noted. We expect to finalize our procedures by 10/31/2020.

2. Procurement Services written procedures need to be updated and formalized to clarify expectations and monitoring processes to ensure supplier compliance with FW/FW requirements related to contracts for services.

Issue: Procurement Services has process flowcharts and endeavors to adhere to procedures and policy, but written procedures lack clarity in outlining expectations for monitoring supplier compliance. To facilitate clear expectations and promote consistency, procedures should be written and communicated to clearly identify roles and responsibilities, including controls activities around monitoring and follow-up with suppliers to ensure FW/FW Plan compliance. Procedures should include an escalation process where appropriate so supplier noncompliance can be timely resolved. Procurement Services can reduce potential risk and improve supplier compliance by updating and communicating procedures to include important roles and compliance monitoring responsibilities to staff involved in monitoring compliance with the FW/FW Plan.

Recommendation: Procurement Services should update, formalize and communicate its procedures to clarify roles, responsibilities and expectations of Procurement staff in implementation, monitoring and follow-up of FW/FW Plan requirements.

Management Corrective Action: UC Merced Procurement Services will review UCOP guidance in implementation of the FW/FW Plan, formalize into a UC Merced procedure, and assign task level responsibilities to procurement staff. We expect to finalize our procedures by 10/31/2020.

3. Procurement services needs to Improve monitoring of contracts requiring annual certification and independent verification of supplier compliance with FW/FW Plan requirements.

Issue: Procurement services needs to improve oversight of supplier compliance to ensure more timely receipt of certifications from suppliers requiring annual verification and ensure certification documents are appropriately completed and signed by a valid independent entity as required by the FW/FW Plan. In our testing of contracts requiring annual verification procedures and independent certification of compliance with FW/FW Plan requirements in 2019, we noted that Procurement Services did not always receive timely and valid independent certification documents as required. While this is a supplier responsibility, Procurement Services must assign staff to formally follow-up with and ensure supplier compliance with the FW/FW Plan requirements.

Certifications are due three months after the anniversary date of the annual verification period. All three certifications we reviewed were late, one was 11 months late. There was not a rigorous monitoring process in Procurement Services to help ensure more timely receipt of certifications. Additionally, no review of certification documents was routinely performed to determine if they were valid and met requirements of the FW/FW Plan. One certification document was not signed by an independent auditor as required by the FW/FW Plan. It was signed by the owner and CEO of the company who did not appear to understand the requirements, nor was he able to provide a record of verification procedures as required under the audit section of the FW/FW Plan. There is no independence when the CEO and owner of the company verifies their own practices and signs the certification claiming there was an independent audit performed. The University of California annual verification standards state that:

- 1. Annual verification procedures must be performed by a licensed public accounting firm or the supplier's internal audit department.*
- 2. Annual verification procedures can only be performed by the supplier's internal audit department if the internal audit function reports directly to an independent board.*
- 3. If the annual verification procedures are performed by a licensed public accounting firm, the accounting firm must have no affiliation with the supplier.*

Recommendation: Procurement Services should revise its practices and management controls to include rigorous follow-up, monitoring and escalation processes that ensure annual certifications are received timely from vendors and that certified verifications are valid and in compliance with FW/FW Plan requirements. Specifically, Procurement Services should:

- Strengthen its FW/FW compliance activities to assign roles and responsibilities for Procurement follow-up and review of annual certification documents;
- Design and perform management controls to include monitoring and oversight of follow-up and review of annual certification documents and verification of controls completion; and
- Document the follow-up and escalation process when vendors don't comply to evidence due diligence of supplier oversight.

Management Corrective Action: Procurement will make best efforts to implement a holistic proactive process to provide reminders to suppliers when certifications are due and continue to provide reminders or address deficiencies if certifications are not provided in a timely manner. Specifically, Procurement Services will revise its controls activities to ensure roles and responsibilities are assigned to strengthen compliance with the UC FW/FW Plan requirements. Additionally,

Procurement Services will put more rigor around management controls and oversight of completion of the verification follow-up and review process for annual verifications due and ensure escalation procedures are clearly understood and monitored.

4. Procurement Services needs to continue to ensure its reporting of contracts subject to FW/FW Plan requirements is accurate to facilitate timely audit, monitoring and follow-up as required by the Plan.

Issue: Procurement Services provided reports that lacked reliable contract information to accurately identify contracts meeting FW/FW Plan requirements in 2019. During our review, we noted that the number of contracts reported by Procurement as meeting FW/FW Plan annual verification requirements seemed low compared to previous years. We also noted that several contracts in the reports appeared to have inconsistent information. We performed additional audit procedures to review underlying data and attempt to validate information in the reports. Our review noted several contracts where dates were incorrect resulting in under identifying contracts subject to FW/FW annual verification requirements for the audit period. Procurement provided a new report with information corrections that agreed with results of our additional audit procedures. Procurement should continue to verify it has a reliable and tested report that reflects current, accurate and complete information to facilitate timely audit, follow-up and monitoring, and to help ensure appropriate supplier compliance oversight with FW/FW Plan requirements.

Recommendation: Procurement Services should ensure that reports used to identify contracts with FW/FW requirements are accurately capturing information used for auditing, monitoring and follow-up with vendors in accordance with FW/FW requirements. Procurement Services was able to provide updated information during our audit and should continue to work with IT to improve and verify the accuracy of reporting in the future. It is critical that current, accurate and complete information are available to help ensure supplier compliance.

Management Corrective Action: Procurement Services believes they resolved this issue during the audit and no additional action is required.