

RIVERSIDE: AUDIT & ADVISORY SERVICES

January 30, 2012

To: Russ Lewis, Director
Materiel Management

Subject: Sole Source Purchase Orders

Ref: R2012-16

We have completed our audit of Sole Source Purchase Orders in accordance with the UC Riverside Audit Plan. Our report is attached for your review. We will perform audit follow-up procedures in the future to review the status of management action. This follow-up may take the form of a discussion or perhaps a limited review. Audit R2012-16 will remain open until we have evaluated the actions taken.

We appreciate the cooperation and assistance provided by your staff. Should you have any questions concerning the report, please do not hesitate to contact me.

Michael R. Jenson
Director

Attachment

Xc: Audit Committee Members

UNIVERSITY OF CALIFORNIA AT RIVERSIDE
AUDIT & ADVISORY SERVICES
MEMBER OF ASSOCIATION OF COLLEGE & UNIVERSITY AUDITORS

INTERNAL AUDIT REPORT R2012-16
SOLE SOURCE PURCHASE ORDERS
JANUARY 2012

Approved By:

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Sr. Principal Auditor

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**UC RIVERSIDE
SOLE SOURCE PURCHASE ORDERS
INTERNAL AUDIT REPORT R2012-16
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I. MANAGEMENT SUMMARY

Based upon the results of work performed within the scope of the limited review, it is our opinion that, overall, the Purchasing Department's system of internal controls on Sole Source Purchase Orders is operating satisfactorily and generally in compliance with University policies and procedures.

Positive observations include:

- UCR's online eBuy Purchase Order and Requisition System (eBuy), a campus web-based application, requires users to disclose how the vendor was selected using the vendor selection types in eBuy thus allowing the Purchasing Department to extract the purchase orders by type and determine the campuswide purchase activity including sole source for statistical and reporting purposes.
- Campus policies provide guidance in the implementation of Business and Finance Bulletin BUS-43, Materiel Management, and BUS-34, Independent Consultants, including requirements for sole source decisions, and step-by-step procedures in the use of eBuy.
- Purchasing Department management and buyers not only review sole source purchase requisitions and justifications to ensure compliance with applicable policies, but also inform users of other possible vendors and products/services and negotiate for the best possible product/service and pricing.

We observed some areas that need enhancement to strengthen internal controls and/or effect compliance with University policy:

The volume of campus sole source purchase activity extracted from eBuy did not appear to be reasonable. Users appeared to have not been appropriately using the vendor selection type capability of eBuy. (Observation III.A)

This is explained in greater detail in Section III of this report.

II. INTRODUCTION

A. PURPOSE

UC Riverside Audit & Advisory Services, as part of its Audit Plan, performed a limited review of Sole Source Purchase Orders to evaluate compliance with certain University policies and procedures, efficiency and effectiveness of selected operations and adequacy of certain internal controls.

B. BACKGROUND

The Campus Purchasing Department (CPD) is responsible for the processing and oversight of the majority of campus purchases. CPD directly handles most individual purchase orders valued at more than \$2,500. CPD provides assistance to campus departments in locating the best sources for needed materials and services, and the most reasonable prices.

Seven CPD buyers reporting directly to the Purchasing Manager are responsible for coordinating with campus department purchasing assistants and creating purchase orders. Products and services assignments of buyers are listed in the department's website. Each buyer is given maximum signature authority depending on their position title, as follows:

- Buyer II - \$25,000
- Buyer III - \$50,000
- Buyer IV - \$75,000
- Purchasing Manager - \$100,000
- Director - Unlimited

This audit is limited to sole source purchases. As defined in UC Business and Finance Bulletin BUS-43 (BUS-43), *Materiel Management*, sole source is the only supplier capable of meeting University requirements within the time available, including emergency and other situations which preclude conventional planning and processing. The campus implementing policy, UCR Campus Policy Number 750-60 (CPN 750-60), *Purchase Requisitions and Purchase Orders*, defines sole source purchase as based upon the fact that only a specific product/service, available only from a particular vendor, can fulfill UCR's requirements.

C. SCOPE

The scope of the audit covered sole source-related processes and controls within the Purchasing Department (CPD) and the procedures at the campus departments. Audit & Advisory Services reviewed selected

records supporting transactions that occurred between July 2010 and June 2011, and examined procedural controls relating to sole source purchases. The audit was limited to the following procedures:

1. Obtained and reviewed purchasing policies and procedures, including organizational and government requirements, relevant to the campus.
2. Interviewed the Campus Purchasing Manager and obtained information on the CPD's various processes related to sole source purchases. Obtained CPM's responses to Internal Control Questionnaire (ICQ).
3. Evaluated internal controls based on management responses to the ICQ.
4. Obtained statistical reports regarding purchase orders processed by the campus in FY 2010-2011.
5. Selected a sample of 10 campus departments and interviewed their Financial and Administrative Officers and Purchasing Assistants and obtained their perspective and their procedures on the sole source purchasing function.
6. Obtained an extract from eBuy of Fiscal Year 2010-2011 purchase orders marked sole source. Selected a sample of 40 sole source purchase orders (SSPO) that included all 14 SSPOs valued at more than \$100,000 and reviewed for adequacy of documented justification and appropriate departmental and CPD approval for use of a single source as well as basis for concluding the price is reasonable.
7. Reviewed consecutive SSPOs to the same vendor for potential splitting of orders to avoid dollar thresholds for approval, cost analysis, and submission of cost or pricing data.
8. Determined if requisitioning and procurement personnel are required to disclose financial or ownership interest in suppliers and if such disclosure procedures are followed.
9. Determine if specific vendors are receiving an unusual amount of SSPOs.

D. INTERNAL CONTROLS AND COMPLIANCE

As part of the review, internal controls were examined within the scope of the audit.

Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations

Our substantive audit procedures were performed in August to September 2011 (not inclusive). Accordingly, this evaluation of internal controls is based on our knowledge as of that time and should be read with that understanding.

III. OBSERVATIONS, COMMENTS, AND RECOMMENDATIONS

A. Campus Sole Source Purchase Activity

The volume of campus sole source purchase activity extracted from the eBuy System did not appear to be reasonable. Departmental Transactors appeared to have not been appropriately using the vendor selection type capability of eBuy.

COMMENTS

The eBuy System has the capability of extracting statistical information on POs by vendor selection type and generating a report that shows selected fields such as PO number, vendor name, department, and amount. eBuy's Purchase Order program includes a "selection" tab that requires transactors during PO creation to mark the appropriate box(es) on how the vendor was selected. There are 14 Vendor Selection (VS) types in eBuy: UC Agreement, UC Price Schedule, local agreement, best source, multiple quotes, multiple phone quotes, only known source, sole source, match existing, targeted vendor award, emergency purchase/repair, reimbursement, unauthorized purchase, and other. The system does not limit marking only one VS type. From our sample selection, we noted some sole source marked POs were also marked match existing, best source, local agreement, and/or UC agreement. Also, it is possible that some sole source purchases were not marked as such. Testing for this was not in the audit's scope.

FY 2010-2011 POs marked "sole source" extracted from eBuy are presented below:

	No. of POs	Total Amount
Sole Source POs (SSPO)	2,005	\$ 9,879,758
Campuswide POs	80,755	75,029,062
% of SSPOs to Total	2.5%	13.2%

To compare the UCR sole source purchase activity with that of other UC campuses, an attempt was made to solicit sole source purchase activity at three other UC campuses but only one response was received. The campus indicated that it did not have the capability to identify sole source purchase orders from its purchasing system.

A breakdown of the transactor coded 2,005 SSPOs by amount is as follows:

	No. of POs	Total Amount
>\$100,000	14	\$ 4,667,274
\$75,001 - \$100,000	8	720,070
\$50,001 - \$75,000	14	876,557
\$25,001 - \$50,000	30	976,151
\$2,501 - \$25,000	231	2,001,193
<\$2501 (DAPOs)	1,662	638,513
Sub-Total	1,959	9,879,758
Canceled POs	46	0
Total	2,005	9,879,758

A cursory review of the SSPOs showed the actual number of SSPOs should be lower. A substantial number of the SSPOs (DAPOs created and approved at the campus department level) appeared to have been erroneously classified as "sole source" due to the following reasons:

- POs issued to vendors who have been pre-approved by Purchasing were marked sole source rather than local agreement in the VS type.
- During PO creation in eBuy, department transactors used previously completed POs as templates that were marked sole source and no changes to the VS type was made. In one department alone, 664 POs were created that used a previously sole source marked PO as template; the VS type for the POs should have been local agreement.

Presented below are the SSPOs we identified that should have been marked a different VS type other than "sole source" and canceled POs without values:

	Purchase Orders	Number	Total Amount
1	Covered by UC Agreements	177	\$ 111,534
2	Covered by UCR Local Agreements	725	333,683
3	Best Source	58	18,390
4	Canceled POs	46	0
	Total Identified Non-SSPOs	1,006	463,607
	Total of Extracted SSPOs from eBuy	2,005	9,879,758
	Net SSPOs	999	9,416,151

Selected departments interviewed indicated the following:

- Identification of VS type and marking of POs as sole source was based on definitions of sole source and match existing contained in CPN 750-60.
- There were no definitions on the other VS types for proper identification and guidance of campus transactors: UC Agreement, UC Price Schedule, local agreement, best source, multiple quotes, multiple phone quotes, only known source, match existing, targeted vendor award, emergency purchase/repair, reimbursement, unauthorized purchase, and other.

While the Purchasing Manager shared with CPD buyers via electronic mail (email) on 9/23/2008 the definitions of the VS types, it did not appear that campus department transactors received this information. A department Financial and Administrative Officer suggested that definition links or "pop-ups" be installed for each VS type in eBuy's "Selection" screen to serve as quick reference and guidance for transactors during PO creation.

RECOMMENDATIONS

The Purchasing Department should:

- Provide campus department management and their purchasing staff with the VS definitions from the Purchasing Manager. For VS UC agreement, consider posting a quick link to UC-approved purchase agreements in the Materiel Management/Purchasing website.
- Consider adding definition links or "pop-ups" in eBuy's selection screen to serve as reference to transactors in identifying the vendor selection type while creating purchase orders.
- Remind department transactors to ensure that the appropriate VS type is marked when using previous POs as templates in creating new POs.

MANAGEMENT RESPONSE

- EBuy welcome page will be updated with a link to UCOP strategic sourcing agreements.
- EBuy will be updated to provide easy access to definitions for vendor selection choices appearing on the selection tab (by "hovering", by "?" links or similar).

- EBuy will be updated so that the “copy as new” (template) feature will NOT copy the selection tab data of the original transaction to the new transaction. Thus, the selection tab must be completed for each and every transaction independently. (Excludes Purchasing-designated-vendor eBuy agreements which automatically indicate Purchasing’s selection codes for all DAPOs issued against them).

It should be recognized that as a research institution it is not unusual to have a greater number of sole source transactions than might be found in non-research or other environments. The 999 (1.2%) transactions identified under this audit as likely sole source purchases does not seem unreasonable in such an environment.

Transactor’s marking of POs as “sole source” as well as “UC agreement” or “local agreement” or “match existing” and similar does not necessarily suggest an error in the vendor selection method. Indeed, a purchase order may be issued to a UC agreement source, but that source may also be the sole source for the item. Certainly a Transactor could mark the transaction as “UC agreement” and nothing more would be required, however, in an effort to be as accurate as possible, both blocks may be marked. This indicates the Transactor was aware of both considerations in their selection of the vendor.

It should also be recognized that the vast majority of transactions within the authority of departmental Transactors are <\$2500. These transactions are of a level that competition is typically not mandatorily required (although perhaps prudent). Transactors could easily mark such transactions as “best source” or “other” and not be faulted for their selection. Marking of a transaction as sole source, when the Transactor believes that to be accurate, should not be discouraged through criticism of their selection process markings.

B. Sole Source Purchase Process (Formal)

The process starts with the user requesting procurement of a specific product (often equipment) or service from a sole source vendor. The user creates a requisition in eBuy and provides a written justification that is submitted to the Purchasing Department for procurement action. Requisitions are referred to the buyers based on their commodity assignments and they review the sole source requisitions and justifications to ensure they comply with policy requirements.

Most sole source purchases involve specialized scientific equipment for which users provide specific product descriptions and features. Under

CPN 750-69, *Campus Purchasing Policy and Requirements*, competition must be sought for any transaction expected to involve an expenditure of \$100,000 or more by as broad a solicitation as the situation indicates from sources believed most likely to be able to provide the required goods or services in the required time. Such solicitation shall be from at least three sources when possible and may, in a limited market, include written inquiries to determine supplier interest and capability, with the following exceptions (that include): (a) a unique item which is available only from a sole source, and (b) an item which is not unique, but which must match existing equipment located in the same installation or facility and such item is available only from a sole source. Also, CPN 750-60 requires sole source purchases exceeding \$10,000 to be accompanied by a written justification based on functional information and/or performance requirements that are necessary to accomplish the educational or research objectives for which the item is being proposed.

Since there is no competitive bidding for sole source purchases particularly for those below \$100,000, there is a risk that UCR may not receive the best product/service and/or pricing. To address this risk, buyers review the validity and reasonableness of sole source purchase requisitions in accordance with systemwide and UCR policies. Buyers identify other possible vendors/sources and sometimes recommend other vendors and similar products to the user. However, most often, the users are adamant about purchasing the equipment from vendors that they have identified as meeting their specific requirements. Buyers negotiate with the sole source vendors for best pricing and often obtain discounts during the process. After negotiations, a two-part sole source justification memo that covers vendor selection and price reasonableness is prepared and signed by the buyer and, depending on the amount involved, by the Purchasing Manager and/or the Director too. Documentation on each PO that includes justifications, negotiations with the vendor, coordination with the users, and a signed copy of the PO is maintained by the Purchasing Department.

Our review and evaluation of the system of internal controls over sole source purchasing processes and procedures disclosed adequate controls exist to ensure compliance with policy requirements and accomplish campus business objectives.

C. Sample Review

1. Summary

A sample of 40 POs totaling \$5,557,038 (59% of total SSPOs of \$9,466,055) consisting of all 14 POs (totaling \$4,667,275) each valued at greater than \$100,000 and 26 POs (totaling \$889,763) each valued

at less than \$100,000 (24 of the 26 POs were valued at \$10,000 or more) were selected and reviewed for the following:

- Existence of justification of vendor selection and price reasonableness
- Evidence of negotiation between buyer and vendor on pricing
- Evidence of locating other possible vendors
- Evidence of conflict of interest

2. Results of Review

Twenty-five (25) POs were supported by written justification memos prepared by the assigned buyers and approved/signed by the Purchasing Manager and/or Director. Ten (10) POs were actually renewal of existing maintenance and support agreements or training and two (2) POs were for similar previously purchased equipment. Justification on three (3) POs was entered in eBuy in the VS comments.

In our interviews of a sample of 10 campus departments, when asked about disclosure of Conflict of Interest (COI) by employee-vendors, the Financial Managers responded that if an employee-vendor relationship is disclosed, they complete the necessary forms. Campus policy on COI, including employee-vendor relationship, is posted on Materiel Management's website. Also, in compliance with the requirements of the National Institutes of Health (NIH) and National Science Foundation (NSF), principal investigators who received grants from those agencies complete the Form 700-U Statement of Economic Interests for Principal Investigators (SEI) and submit them to the Office of Research.

There was only one PO (from an academic department) in our sample where an employee-vendor disclosed a potential COI. The requisite Report of Proposed Purchase Transaction Involving Possible Conflict of Interest was completed and signed by the employee-vendor in compliance with the requirements of BUS-43 and CPN 750-63, *Purchasing Authority*. The PO required a Director from another department that is under Finance and Business Operations (FBO) to give prior approval on the equipment design and fabrication, and to inspect the completed project for compliance with the pre-approved design. This assessment by management independent of the academic department was a control procedure that ensured the validity of the transaction awarded to the employee-vendor. Documentation on the approval and final verification by the Director of the other department was obtained and verified during our review.

Risks associated with potential COI by employee-vendors are addressed in the A&AS annual Financial Analytic Review. An audit procedure of matching addresses of employees and vendors is conducted, and possible COI may be identified in that review.