



The Hill
Internal Audit Report No. I2014-103
April 15, 2015

Prepared By

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INTERNAL AUDIT SERVICES
IRVINE, CALIFORNIA 92697-3625

April 15, 2015

**KIMBERLY VATER
STORE MANAGER
UNIVERSITY BOOKSTORE - THE HILL**

**RE: The Hill Audit
Report No. I2014-103**

Internal Audit Services has completed the review of The Hill and the final report is attached.

We extend our gratitude and appreciation to all personnel with whom we had contact while conducting our review. If you have any questions or require additional assistance, please do not hesitate to contact me.

Mike Bathke

Mike Bathke
Director
UC Irvine Internal Audit Services

Attachment

C: Audit Committee
Dan Dooros, Associate Vice Chancellor - Student Affairs
Brice Kikuchi, Chief Financial Officer - Student Affairs
Sergio Ramirez, Sr. Financial Analyst – Accounting and Fiscal Services

I. MANAGEMENT SUMMARY

Internal Audit Services (IAS) reviewed business operations and financial activities, within the University of California, Irvine (UCI) Bookstore, now known as The Hill. Certain internal controls and process improvements could be strengthened to ensure compliance with University policies and procedures and/or best business practices. The following issues were noted.

Budget and Accounting – Financial reports used by The Hill and Student Affairs are inconsistent and lack important detail. Processes and controls over purchases on account (recharges) need improvement. The details related to these issues are provided in section V.1.

Cash Handling – The Hill is not in compliance with University cash handling requirements over deposit preparation, cashier accountability, voids and refunds, physical security, and disposal of sensitive information. The details related to these issues are provided in section V.2.

Receiving Controls – Receiving controls need improvement. Some product shipments are not getting received accurately leading to inventory variances. The details related to this issue are provided in section V.3.

Written Policies and Procedures – Policies and procedures need to be better defined and documented. The details related to this issue are provided in section V.4.

Information System Support and Management – Key information technology (IT) controls and processes have not been implemented or documented. The details related to this issue are provided in section V.5.

II. BACKGROUND

The Hill is a department under the Vice Chancellor, Student Affairs and has a staff of approximately 17 full time employees and 140 student employees. It was established in 1981 and is currently located at the UCI Student Center. It is a not-for-profit, self-supporting organization owned by UCI operating on behalf of the

campus community. Any surplus revenue generated is used for programs in the division of Student Affairs.

The Hill was an independent unit that was placed under the Student Center and Events Services (SCES) management in 2011. In June 2014, the store once again became an autonomous unit reporting directly to the Associate Vice Chancellor, Student Affairs.

III. PURPOSE, SCOPE AND OBJECTIVES

The scope of the audit focused on certain operational and financial activities from July 2012 to present. The review was designed to determine whether sufficient internal controls, policy compliance, and IT operations are in place, and demonstrate best practices in business operations.

The audit included the following objectives:

1. Evaluate whether there are adequate controls over budgeting and financial reporting and verify whether ledgers are reviewed and reconciled in a timely manner;
2. Review and assess recharge procedures and processes to determine if the activity complies with University policy;
3. Review cash handling processes for conformance with UC/UCI policies and procedures and for assurance that collected funds are properly recorded, secured, reconciled, and deposited;
4. Evaluate receiving control procedures including returns, sample inventoried items, assess physical security procedures, and review established policy and procedures to determine whether current practices comply with policy.
5. Assess and review selected IT general controls.

IV. CONCLUSION

In general, the selected processes reviewed from The Hill appear to be functioning as intended. However, business risks and control concerns were identified with financial reporting, recharges, cash handling, the receiving control process, written operating procedures, and key IT controls and processes.

Observation details were discussed with management who formulated action plans to address the issues. These details are presented below.

V. OBSERVATIONS AND MANAGEMENT ACTION PLANS

1. Budget and Accounting

Background

UCI policy states that each manager who is directly responsible for the financial affairs of that activity should maintain procedures that monitor and verify transactions to the general ledger on a monthly basis. Departments have a responsibility to ensure the appropriateness and accuracy of all financial transactions applied to their ledger. IAS reviewed The Hill's financial reports from July through December 2013.

Observation

Financial Reporting

The Hill's financial reports are not comprehensive enough to state the unit's financial position and are not reliable, accurate, or timely enough for management decisions. Because The Hill is a self-sustaining auxiliary service, basic accounting standards call for an accurate reporting of income and expense to determine its viability.

IAS reviewed and compared the monthly business office (BO) report maintained by SCES Finance with the Student Affairs quarterly report (Aux) to test whether the financial information was verifiable and reliable. The BO report is used for monthly tracking of financial data, which helps guide The

Hill's management in its operation whereas the Aux quarterly report is a monitoring tool used by Student Affairs.

IAS noted that information is inconsistent between the BO report and the Aux report. Some numbers do not match between the two reports and management could not explain the differences. For example, in the Aux report, salary charged to The Hill's Admin account and the Computer Store account matched the general ledger entries, but in the BO report, \$27,435 in salary was moved from the Computer Store account to the Admin account. There is no explanation for the salary movement, resulting in the BO report understating the Computer Store expenses compared to the Aux report and the general ledger. IAS also noted unexplained differences in revenues. There were five revenue line items (comprised of three accounts and four funds) totaling \$12,220 that were noted in the Aux report but missing from the BO report.

The Hill also has three balance sheet accounts that record the daily receipt or transactions of departmental recharges (TOES), Veteran's Administration/ Department of Rehabilitation (VA/Rehab) funds, and gift certificates. Reconciliation of these amounts is completed through journals that utilize source codes to match the individual transactions to the daily totals. These accounts do not appear in either report and do not appear to be monitored. As of April 2014, in the TOES account, transactions that lacked any matching source codes totaled approximately \$2.4 million. Including these accounts in the financial report will help monitor the transactions and assure their reconciliation in a timely manner.

There are also instances of delays in reporting deposits into the general ledger (see 2. Cash Handling – Journal Preparation below). Income that cannot be traced to the proper month earned may distort financial information and the results become meaningless for budgetary tracking and analysis.

Inaccurate reporting of income and expense creates an unreliable financial report. Without an accurate profit and loss statement that can be derived from the financial report, The Hill's management cannot effectively manage operations.

Recharges

Process and procedures over the handling of inter-departmental recharges need improvement. Staff and faculty utilize The Hill for their business and personal purchases. IAS noted that The Hill does not have adequate resources to examine every departmental purchase to determine its validity which may expose the University to potential fraud. Furthermore, the use of the departmental recharge process for in-house purchases is time-consuming, inefficient, and the purchase could be non-compliant (as defined by extramural fund terms and conditions). Under the current method, there are no assurances that (a) the buyer is an authorized purchaser; (b) the account and fund submitted are valid; (c) the purchase is authorized and appropriate; and (d) denial of the transaction will not cause customer service problems. IAS recommends that the campus procurement card, PALCard, be used as a means for business-related purchases.

Management Action Plan

Based on the observations in the financial reporting area, our action plans include the following:

Financial Reporting

As of July 2014, management has transitioned most of the financial reporting of The Hill to the new Quali Financial System's ledger. Managers and merchandisers have access to the system for their review. Likewise, sub-department heads (e.g., head of coursebooks, head of clothing departments) are being asked to review their ledgers and document that it meets University guidelines.

The Hill has taken additional measures to maintain, review, and analyze its financial data. Training was conducted in September 2014 by Sequoia, the point-of-sale (POS) software provider. Covered topics included the creation and scheduling of reports. Sales reports are generated and reviewed daily, weekly, monthly, and quarterly. These reports are also compared and balanced against the ledger. Store reports are prepared and completed once the ledger has closed for the fiscal month and the information is provided to the staff immediately. These reports include: departmental and overall sales performance, class sales (a more detailed breakdown of merchandise sales),

and sales versus budget. The POS system also includes a stock ledger module that had not been utilized. It is currently being updated and will be able to assist in the creation of income statements and a profit and loss statement.

Since the audit process began several staff changes have also occurred. The Hill had been utilizing campus temporary services. Recruitment was completed for an Accounts Receivable Analyst. The candidate selected has a strong retail background which includes prior campus and campus bookstore experience. In addition, the store maintains a 50 percent position filled by a prior financial manager whose knowledge and experience of accounting, store, and University processes has been instrumental in organizing the financial data.

Recharges

The Hill management polled some of their clients about transitioning from departmental recharge to only PALCard. The Managers of Academic and Administrative Business Offices felt that this would make it difficult for their offices because not all faculty and staff have PALCards. In the meantime, management will continue to process departmental recharges. However, The Hill will require identification (ID) for each buyer who wants to use departmental recharge for payment. If the buyer does not have ID, customer service staff will call the department to receive verbal authorization. IAS has verified this process. No further action is required.

2. Cash Handling

Background

Business and Finance Bulletin 49 establishes the University's policies related to handling and processing of cash and cash equivalents, and defines roles and responsibilities related to receipt, safeguarding, reporting and recordkeeping for all University cash and cash equivalents. Its purpose is to ensure that University assets are protected, accurately and timely processed, and properly reported. The bulletin also establishes basic internal control principles (accountability, separation of duties, security, and reconciliation) in regards to collecting and accounting for cash and cash equivalents.

Observation

Deposit Preparation

Deposits are not validated and prepared under dual custody at all times in a safe and secure area. The Main Cash Handler works independently from the rest of The Hill's employees regarding cash counting and deposit/journal preparation. There is usually a student worker in the office, but the student is not tasked with witnessing the actual cash count.

Failure to validate deposits weakens the control structure and may lead to loss or theft.

Cashier Accountability

Individual accountability must be maintained and documented for all cash handling procedures. Although each cashier has their own login to their cash terminals, cash counts are only done at the end of the day by the final shift. There are no counts conducted after each shift ends; therefore, it is difficult to pinpoint any discrepancies to any one cashier. Because The Hill cannot with certainty isolate problematic transactions pertaining to a specific cashier, conducting trend analyses or assigning individual accountability based on a cashier's actions is difficult.

Failure to maintain adequate accountability over cash related functions may result in diversion of University funds.

Voids/Refunds

University policy requires that voids and refunds to be fully documented and explained as well as approved in writing by the supervisor. Transactions known as "trans-voids" are not documented, adequately reviewed, or approved in writing by the supervisor. And although the POS system records all voids and refunds, the Main Cash Handler does not reconcile the submitted voids or refund receipts to this report.

Inadequate management of voided and refunded transactions increases the risks of fraudulent transactions being processed subjecting the University to unnecessary financial loss.

Physical Security

As of July 2, 2014, the safe combination had not been changed even though the former Main Cash Handler's employment ended in April 2014. A safe's combination must be changed whenever a person who knows the combination leaves a cash handling unit. In addition, the combination must be changed at least once a year. Documentation must be maintained showing the date and the reason for the combination changes. Also, the log for the daily count of the contents of the vault should be manually signed and dated to verify the presence of two individuals.

Failure to maintain adequate security over cash may result in diversion of University funds.

Sensitive Information

Disposal of sensitive payment information is not performed according to University policy. The Hill scans all their daily cash receipt supporting documentation. IAS observed that once scanning and quality assurance of the images was completed, the documents were placed in their entirety in open recycling bins. By not adequately destroying documents with personal information (e.g., copies of personal checks), The Hill may expose the University to opportunities of identity theft or breach of confidential information.

Journal Preparation

IAS sampled four cash deposit journals.

Sales Date	Journal Prep Date	Journal Send Date	Number of Days
7/6/12	7/9/12	7/24/12	18
6/6/13	7/1/13	7/8/13	32
4/3/14	6/6/14	6/6/14	47
4/9/14	4/30/14	5/13/14	26

The amount of time from sales date to journal preparation to send is excessive. Even though the cash receipts are deposited within a day, the delay in recording of the income into the general ledger prevents the timely reporting and reconciliation of the income accounts. This may lead to inaccurate reporting in profit/loss statements that help manage The Hill's operation.

Management Action Plan

During the audit review period, The Hill was undergoing a transition of management and staff. We have since transitioned the management from the Student Center to the Auxiliary Services Office. The responses below reflect plans of the new management.

Deposit Preparation

We have a new main cash handler who prepares the tills and the deposits. Due to limited resources/staffing and to mitigate risk, we have steps in place to hold the cash handler accountable. After the tills come into the secured office, the cash handler counts the cash and puts the cash fund into the vault. The deposit is then prepared and validated in dual custody (with the store manager or another full-time accounting staff member). The deposit is also validated with the POS z-reading. Any discrepancies are noted and signed off by the two employees. Then the vault is counted by two employees to make sure it balances to the change fund total. All counts and validations are documented and placed in a business day folder. IAS has verified this process. No further action is required.

Cashier Accountability

Each cashier is assigned their own unique log in number and password. We have created a report called "End of Shift" which will detail each cashier's activity for their shift. Information included is comparable to our X and Z terminal reports which detail all tender, sale, return, discount, and void activity. We will use the End of Shift reports to identify potential patterns of behavior that will result in a loss to the store. For example, if a cashier is processing fraudulent cash refunds, benchmarking the cash refund data across all cashiers can highlight either a training issue or fraud. The high activity registers will also be switched out at the mid-day point to mitigate

potential loss and narrow the scope of timing. Several security cameras are specifically designated for all register areas of the store. The over/shorts will continue to be monitored as well. Implementation will take place by May 2015.

Voids/Refunds

Post void transactions are now signed by the cashier and supervisor with the reason for the void documented on the receipt. Cancelled transactions also produce a receipt for documentation. Both types of transactions are recorded per register and reconciled against the z-report by the Main Cash Handler. IAS has verified this process. No further action is required.

Physical Security

The safe combination has been changed and only five individuals have access to the safe. When we have staff turnover, we will change the safe combination. To ensure this will be done in the future, we will add this process in our desk manual. IAS has verified this process. Implementation for the written procedure will take place by October 2015.

Sensitive Information

As of July 2014, our accounts receivable staff no longer makes copies of personal checks. Any existing copies of checks will be shredded. IAS has verified this process. No further action is required.

Journal Preparation

The Hill's journal preparation to send process is now within five business days. The Main Cash Handler now has a back-up so journals are being completed within 72 hours. IAS has verified this process. No further action is required.

3. Receiving Controls

Observation

IAS noted that some product shipments are not getting processed or received accurately. IAS noted that some inventory is placed on the floor and sold prior to being scanned and received in the POS system, which creates variances in accounting for purchases, quantities on hand, and valuation of assets.

Discrepancies between inventory records and physical counts could suggest theft and could also cause errors in the re-order process resulting in stock-outs and lost sales.

Management Action Plan

The receiving department has been reorganized. The Store Manager has streamlined the process to ensure product is received accurately in the system and in a timely manner. Boxes are labeled and dated to alert staff as to their status in the process. The area has been organized and a map has been completed to direct staff where to find and place merchandise, supplies, and fixtures. IAS has verified this process. No further action is required.

4. Written Policies and Procedures

Background

Policies and procedures establish the way a retail business operates on a daily basis and documents the duties of personnel. In addition, written procedures are valuable in training new employees and serve as guides for strong administration and controls over operations.

Observation

The Hill does not have adequate written policies or procedures for many of their operating functions. For instance, IAS noted that although training was given by the outgoing main cashier to her replacement, this was handled over the course of one day and there was little documentation for the replacement to refer to once the former main cashier departed. Furthermore, because

turnovers have created a gap in departmental knowledge, the reconciliation and monitoring of the balance sheet accounts was lost.

The recent updates to the POS system also require that cashier written procedures be revised. Moreover, by incorporating the POS system's updated report generation capability into The Hill's current operations, The Hill can create meaningful reports to support reconciliation, tracking, and analysis of cash handling, sales, and inventory data.

Lack of written policies and procedures can encumber The Hill's ability to conduct its operations and increases the risk that procedures will not be performed as intended. Without established procedures, employees may not perform their job responsibilities consistently and in accordance with management expectations. In addition, standardizing the way identical tasks are performed by employees may increase efficiency and reduce errors.

Management Action Plan

Management's goal is to have a written policies and procedures manual for The Hill by October 2015.

5. Information System Support and Management

Background

IAS was informed that Student Affairs leadership (Auxiliary Services and Resource Planning) made a decision to consolidate The Hill's IT operations under Student Affairs IT. Student Affairs IT will provide oversight of The Hill IT operations and leverage Office of Information Technology (OIT) resources and expertise in IT security, system administration, and risk management. In addition, IAS was informed that the Hill is currently working with Coalfire, the University payment card industry data security standard (PCI DSS) security assessor, Student Affairs IT, OIT, and Main Cashier to implement IT controls and processes that will improve The Hill's IT environment. Consolidating The Hill's IT operations under Student Affairs IT will enhance the support and management of The Hill's systems and IT environment.

Observation

IT controls and processes over information security risk assessments, security plans, change management, patch management, identity and access management, log management, and contingency plans have not been implemented and documented.

Management stated that in the past, The Hill's IT operations were supported and maintained solely by The Hill staff. Also, The Hill lacked sufficient IT resources such as an IT professional staff with the necessary training to fully support the unique IT and security needs of their systems.

Management Action Plan

The Hill, Students Affairs IT, and OIT will continue to work together to transition the support and management of The Hill's IT systems and environment under Students Affairs IT to leverage OIT processes and controls such as change management, patch management, identity and access management, log management. The Hill will also benefit from OIT expertise in IT security, system administration, and risk management. This change will include a plan for identifying the appropriate resources necessary to support The Hill's IT systems and to allocate those resources to provide the necessary services. In addition, The Hill and Students Affairs IT will complete an IT risk assessment (the Security Risk Assessment Questionnaire - SRAQ) and then create a security plan as a basis for establishing and implementing IT controls and processes. The following were implemented on February 4, 2015:

- Transitioned the support and management of The Hill's IT systems and environment under Students Affairs IT and began implementing established OIT processes;
- Completed the IT risk assessment (SRAQ) for The Hill's IT environment; and
- Created an actionable security plan based on the IT risk assessment and laid out a plan for addressing any security matters.

IAS has verified the above implementation. No further action is required.