

November 27, 2012

VICE CHANCELLOR MILLER

Subject: Audit Report No. M13A001
 Departmental Purchases Audit

Attached is the final report for Audit No. M13A001: Departmental Purchases. It includes action plans that were developed by members of your staff. These action plans will be entered into the TeamCentral Database and monitored until completion. With the issuance of this final report, please destroy any previous draft versions.

I appreciate the assistance provided to me by the Purchasing Department staff, by the department MSO's, and department purchasers during the review. If you should have any questions, please feel free to contact me.



Todd Kucker
Internal Audit Director
UC Merced Internal Audit Services

Attachment

cc: SVP Vacca
 Chancellor Leland
 Assistant Vice Chancellor Ahmed
 Director Deegan

**UNIVERSITY OF CALIFORNIA, MERCED
INTERNAL AUDIT SERVICES**

**Departmental Purchases
Report No. M13A001**

November 27, 2012

Work Performed by:
Todd Kucker, Internal Audit Director

Purpose and Scope

Internal audit has completed an audit of UC Merced's departmental purchasing, which was part of the fiscal year 2013 audit plan. The primary objective of the audit was to evaluate department-level and Purchasing Department monitoring of purchases which have been delegated to departments. The audit steps were designed to cover the following:

- Determine whether low-value, departmental expenditures are consistent with University policy with respect to the types of items that can be purchased, properly approved, allowable by the funding source, and have appropriate supporting documentation;
- Determine whether direct purchasing privileges are properly managed at the department level; and,
- Determine whether direct purchasing activities by departments are appropriately monitored and managed by the Purchasing Department.

There are various classes of orders in the University's purchasing system (CatBuy) as different types of purchases have to comply with special requirements. This audit focused on three classes of orders utilized by departments to complete their own purchasing without the involvement of the Purchasing department: Low Value Orders (LVO's) which provide departments a convenient means to purchase non-restricted supplies and services under \$5,000; T class orders which relate to travel expenditures; and X class orders which relate to employee reimbursements, reimbursements to non-employees (called "One-Time Payees"), and other special items.

The audit included departmental purchases during fiscal year 2012. To test the departmental purchases, a sample of 85 LVO's, T, and X class orders were selected which included purchases by 43 campus departments. Purchase documentation maintained by the departments was reviewed to verify that allowable goods and services were purchased, appropriate documentation was maintained, and the purchases were properly approved. Data analytics software was also utilized to review LVO's and payments to "One Time Payees" during fiscal year 2012.

Purchase card transactions were not included in this audit as the oversight of the campus's purchase card transactions was recently transferred from UCLA to UC Merced's Purchasing Department during July 2012. As a result, new purchase card procedures and controls have recently been put in place.

Background

Low Value Order purchasing authority is delegated to individuals in operating units outside of the Purchasing Department for the purchase of supplies and services that are not available from established agreements or campus service units. The delegation provides a convenient means of obtaining low-value supplies and services quickly.

Low-value purchases are orders that do not exceed \$5,000, per vendor, per day, per department (excluding transportation costs and excluding sales/use tax). Purchases of various types of items and services are not permitted on LVO's as they require special approvals from the Purchasing Department or other departments. These prohibited purchases include services from independent contractors, purchases of controlled substances, on-site labor related services, and rentals.

Other than LVO's, departments also utilize other classes of purchases which do not require Purchasing Department involvement. Class T orders enable a department to purchase travel related services which are not reimbursed directly to a traveler, such as the purchase of airline tickets. Class X orders are used to pay for special items, such as employee training, employee and non-employee (One-Time Payee) reimbursements, postage, and utilities.

Department approvers and the Purchasing Department are responsible for monitoring whether campus purchasing and LVO policies are properly followed. Before receiving the purchasing delegations, employees receive special purchasing training to assure they understand compliance with federal and state law, University policy, and prudent business and financial practices.

Conclusion

Based upon the review, we concluded that departmental purchases are adequately reviewed to verify that the University is only paying for goods and services received by the departments. Departmental use of Low Value Orders could be improved through better monitoring and training. We noted the following areas for improvement:

Areas for improvement:

- Monitoring low-value order purchasing and training departmental purchasers should be improved
- The Purchasing department should further clarify low-value order requirements by updating the written policies
- Improved use of blanket purchase orders and strategic sourcing agreements could result in better prices
- Employee expense reimbursements should be approved by a manager to whom the employee reports
- Further steps should be taken to identify and communicate the risks associated with unauthorized purchases by University employees

Observations

1. Monitoring low-value order purchasing and training departmental purchasers should be improved

During the testing, we noted various items and services which should not have been purchased with a low value order. Many of these items and services were listed in the policy as prohibited from LVO's as the items require special approvals and Purchasing Department involvement.

The following are examples of LVO purchases noted which violated the LVO purchasing policy:

- Orders over \$5,000 (where sales tax and shipping did not push the amount over \$5,000)
- Split orders where more than \$5,000 was purchased with a vendor on one day or on consecutive days
- On-site training
- Employee expense reimbursements over \$500
- Tasers purchased by public safety
- Live animals (mice) for research
- Temporary employment services
- Expenses which should have been capitalized as part of the cost of an asset
- Payments to "One time payees" for services and travel reimbursements (which should have been set up as X class orders)
- Annual software agreements
- Payments for services from individuals which require a 1099
- Rentals of locations and equipment
- Purchases from vendors with which blanket purchases orders had been set up
- Furniture purchases

By utilizing LVO's to purchase these items and services, the University can be put at risk as the appropriate review of the items and services purchased is not completed.

It appears that the cause of the improper use of LVO's has resulted from insufficient monitoring and training. The UC Policy, BUS-43 Materiel Management, requires periodic appraisals to ensure proper performance by departments under the LVO delegations of purchasing authority. Currently, the Purchasing department periodically reviews LVO's during their staff meetings and discusses noted issues with departments, but Purchasing has not yet conducted onsite reviews of purchase documentation maintained by the departments. Although department purchasers receive training in purchasing requirements and the CatBuy system before they receive the delegation, there are not mandatory periodic updates of their training after they complete the initial training. The Purchasing Department conducts monthly meetings to discuss Purchasing-related topics, but departmental purchasers are not required to attend.

Management Action Plan:

The Purchasing department will put together written procedures for monitoring LVO's that will include reviewing purchase documentation maintained by departments. Procedures will be set up to review LVO's by all department purchasers. A refresher training course will be put together which highlights LVO requirements, unauthorized purchases, and other issues noted during the reviews of LVO's.

Campus purchasing policies will be updated to include actions to be taken when violations of the LVO policies are noted by department purchasers. When policy violations are noted purchasers will be required to attend refresher training on purchasing policies. If violations of the purchasing policies continue to be noted in a department, the purchasing delegation for the particular department purchaser will be revoked.

The action plan will be completed by February 28, 2013.

2. The Purchasing department should further clarify low-value order requirements by updating the written policies

The campus purchasing policies should be reviewed and updated. During the audit, we discussed the campus purchasing policies with the Director of Purchasing and noted that some of the written policies were not in line with expectations and daily practices. The policy is sometimes confusing as to whether certain purchases are allowed on LVO's. For example, the policy allows purchases related to employee training, but, per the Purchasing Director, a low-value order should not be used for onsite training as Purchasing should be involved with these purchases. The policy listing of purchases and transactions not permitted under the low-value purchase authorization includes "Reimbursements to UC employees other than those with LVO delegations" while a separate listing of items requiring special approval only prohibits "Reimbursements to UC employees > \$500 (other than travel or entertainment)". To further clarify what can be purchased on an LVO, the policy might include additional explanation and examples of prohibited items and services.

Also, documentation requirements for LVO's should be further clarified in the LVO policy. The current policy explains that departments making the purchases are the office of record. Per the policy, purchase documentation that should be maintained includes a vendor selection/price reasonableness checklist and proof of delivery (packing and/or delivery slip). We noted that many departments don't maintain this information. From discussion with the Purchasing Director, department purchasers should be able to justify why a particular vendor was used, but the Purchasing department doesn't require department purchasers to complete this information for purchases. Also, many departments don't maintain receiving documentation as this information is maintained by the Shipping and Receiving department. As a result, it is difficult to determine whether department reviewers are consistently verifying receipt of the purchased items.

The Purchasing department should update the campus purchasing policies and monitor that departments follow the written policies.

Management Action Plan:

The written campus purchasing policies will be reviewed and updated. Further clarification of what is prohibited from LVO's will be included. Required purchase documentation to be maintained by departments will be reviewed and updated.

After the campus purchasing policies have been updated, the Purchasing Department will begin to complete onsite reviews of departments to verify that required documentation is properly completed and maintained.

This action plan will be completed by February 28, 2013.

3. Improved use of blanket purchase orders and strategic sourcing agreements could result in better prices

During the audit, we noted that the campus might benefit from improving the use of blanket purchase orders and strategic sourcing agreements. By comparing LVO's by vendor with the totals purchased from the vendors, we identified the following:

- Some LVO's were with vendors with which the University already had blanket purchase orders set up; and,
- For some vendors, there was a large volume of LVO's where it would make sense for Purchasing to negotiate a blanket purchase order.

The risk when departments use an LVO rather than an existing blanket purchase order is that the preferred pricing and terms negotiated by Purchasing could be missed on the LVO. In many cases, LVO's were used after the amounts negotiated under the blanket orders were used up.

The campus LVO policy states that items where there is a repetitive requirement should be handled through the Purchasing department under campus wide (local), restricted (department blanket) or System wide (strategic sourcing) agreements. The risk is that the campus is missing out on lower prices that might be negotiated if Purchasing was involved with these purchases.

Management Action Plan:

Departments have the responsibility to notify Purchasing to set up blanket agreements for their area and extend or add money to blanket orders as needed. As part of the refresher training, Purchasing will remind department purchasers to utilize blanket orders when

available and request and establish new blanket orders when there are repetitive purchasing requirements.

Periodically, Purchasing will review instances where there are multiple LVO's with particular vendors to determine whether setting up blanket orders might be beneficial.

This action plan will be completed by February 28, 2013.

4. Employee expense reimbursements should be approved by a manager to whom the employee reports

During the testing, we reviewed segregation of duties between department purchasers and employees who review and approve the purchases. We noted instances where reviewers (MSO's, Administrative Directors, etc.) approved their own expense reimbursements. Although department purchasers were involved with setting up the reimbursements in the CatBuy system, it was often the case that the purchasers reported directly to the employee who received the reimbursement. Additional reviewers for these transactions had not been set up in the review system. A higher level manager to whom the employee reports should approve these transactions.

Management Action Plan:

The current approval system cannot identify and prohibit when the approver is also the payee. Purchasing will update the purchasing policies to require a higher level management approval of employee expense reimbursements. The requirement will be communicated to department MSO's and will be reviewed during Purchasing training.

This action plan will be completed by February 28, 2013.

5. Further steps should be taken to identify and communicate the risks associated with unauthorized purchases by University employees

During the audit, we noted unauthorized purchases for which "After the Fact Justification Approval" was required. After the Fact Purchases are purchase transactions by an employee who is not authorized to contract on behalf of the University. Of the 85 purchases tested, two required after the fact justifications.

One of the After the Fact purchases reviewed was where a researcher purchased a computer on her own and sought reimbursement using grant funding. When grant funding is used to pay for an item, Purchasing department employees review the purchase for typical risks that the purchase could be disallowed by the grantor. An unauthorized purchase bypasses this control. While the purchase was correctly reviewed and approved afterwards, this could have been a disallowable cost and should have gone through the proper review and approval process.

During the audit, we also noted orders in the CatBuy system and Post Authorization Notification (PAN) approval system where vendor invoice information was included in the order. This made it apparent that the purchases had already been completed before the order in CatBuy and the approval process were completed. While the campus purchasing policy requires special after the fact approvals from management for these purchases, the form to identify the unauthorized purchase was not always completed.

These purchases put the University at risk as these employees do not have formal purchasing training and may be unaware that purchases do not comply with laws and University policy. Also, the Purchasing department or departmental purchasers may have been able to negotiate a better price.

The Purchasing department maintains records regarding unauthorized purchases to review for trends such as multiple unauthorized purchases by employees or departments. The volume of unauthorized purchases is not currently reported to campus leadership.

Management Action Plan:

The consequences of unauthorized purchases are outlined in the purchasing policy, and state that the unauthorized purchaser may be held responsible for payment of the charges incurred. These potential consequences have not been enforced. The dollar volume of unauthorized purchases was communicated periodically through February 2012 to the former Ethics, Audit, and Compliance Risk Committee. The campus Ethics and Compliance Program (ECP) was restructured during August 2012.

The volume and noted risks related to unauthorized purchases will be periodically communicated to the new ECP Management Council so the risks to the campus can be properly considered. If the Management Council decides that unauthorized purchases are causing a significant level of risk, it will be their responsibility to communicate the risk and risk mitigation strategy to the ECP Executive Committee and Campus Ethics & Compliance Officer.

The action plan will be completed by December 31, 2012.