



Internal Audit Report

Procurement of Independent Contractors

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I. EXECUTIVE SUMMARY

Audit and Management Advisory Services has completed a review of the effectiveness of controls related to the procurement of independent contractors. This review was included on the FY2018 internal audit plan.

Generally, we found CruzBuy controls within our limited sample to be working relatively well to reduce the risk of fraud, waste, and abuse. Specifically, within our sample of 113 purchase orders, we did not find evidence of price splitting to avoid particular dollar thresholds, purchase orders made to benefit family members, or sole-source purchase orders without proper justification. Furthermore, we found clear evidence of price negotiation, consistent use of pre-hire worksheets, and generally timely processing of requisitions.

While CruzBuy controls appear to be working relatively well to reduce the risk of fraud and waste, After the Fact requisitions are an ongoing risk to the University because these requisitions effectively bypass many of the controls Procurement Services have in place. Procurement Services tracks After the Fact requisitions, which allows the university to understand the magnitude and consistency of the problem. Using this tracking information, we found that during the period of January 1, 2015 to November 7, 2017, a total of 1,161 of 6,058 requisitions (19%) for outside consulting services and miscellaneous outside services were considered “After the Facts.” We found this trend to be consistent over time and spread throughout many divisions. Reducing the frequency of After the Facts would benefit the university by ensuring:

- The best deals on services via Procurement Services negotiations with suppliers
- Contracts stay in compliance with UC policies or state/federal laws
- Departments do not obligate resources that are not in the best interest of the University

In addition, we found some documentation and data entry errors within CruzBuy, although these errors were not typically consequential. The most frequent errors in data entry related to dates when services occurred. Specifically, we found that at least 25% of the dates entered into CruzBuy within our sample were likely inaccurate. However, these dates are difficult for buyers to verify and are not generally relied on for reporting. Another common error was improperly filling in pre-hire worksheets – some requestors would simply check every item in the “Contractor” column for example.

The following observations requiring management corrective action are identified below:

A. After the Fact Requisitions

While CruzBuy controls appear to be working relatively well to reduce the risk of fraud and waste, After the Fact requisitions bypass many of these controls and are a relatively frequent problem.

B. CruzBuy Documentation and Data Entry

We did find some documentation and data entry errors within CruzBuy, although these errors were not typically consequential. However, these errors could reduce the reliability of any analysis performed on CruzBuy requisitions

Agreement was reached with management on all recommended actions to address risks identified in these areas. The observation and related management corrective actions are described in greater detail in section III.

II. INTRODUCTION

Purpose

The original purpose of the audit was to evaluate the effectiveness of controls and determine the appropriateness of the campus use of independent contractors. However, we reduced the scope of this effort to focus only on the effectiveness of controls related to the procurement of independent contractors as a result of evolving priorities within Internal Audit. The appropriateness of the use of independent contractors will be incorporated into a planned audit on a related subject matter regarding the use of consultants. This audit was included on the campus FY2018 Internal Audit Plan.

Background

Generally, independent contractors are those personnel in which the University controls the ultimate product they produce, but not the manner of their performance. Services performed by independent contractors are generally infrequent, technical, or unique functions performed by individuals rather than partnerships, firms, or corporations. Examples of such services include secretarial, drafting, technical editing, translation, and technical appraisals. Independent consultants are a special type of contractor that provides professional or technical advice to the University and the University does not control either the manner of performance or the result of the service. Generally, the use of independent consultants is expected to be infrequent and is primarily used to solve clearly delineated problems.

Individuals who are a University employee or near relative of an employee may only be retained as an independent contractor after it has been determined that the services to be performed by an employee-vendor are not available from other sources. In addition, the work must not be the same or similar to work performed in the scope of a regular University employee.

Procurement and Supply Chain Services

Procurement and Supply Chain Services, a unit within Financial Affairs and ultimately the Business Administration and Services Division, is responsible for providing the tools and business processes for acquiring goods and services at UCSC. Some of the responsibilities for the unit include:

- Managing UCSC's e-procurement tool - CruzBuy
- Conducting bid events and processing procurement transactions
- Delivering procurement training programs
- Providing consultation to help campus departments identify cost-saving opportunities
- Establishing campus and UC systemwide supplier agreements
- Advancing UC systemwide procurement programs

CruzBuy Process

CruzBuy is the e-procurement system used by UC Santa Cruz to procure goods and services from established suppliers.

This application allows requestors to:

- secure better pricing of commonly-used products
- provide one-stop shopping
- reduce time and effort in the purchasing process
- select goods from online suppliers
- produce cost savings through the use of CruzBuy contract suppliers

A requestor (typically from a department) fills in a requisition request using the CruzBuy “Services Form.”

Among other things, this form typically includes as an attachment, or within the requisition form itself, the following:

- At least one quote for the service from the supplier
- An Employee – Vendor Pre-Hire Worksheet for contractors when required
- Certificate of insurance for the contractor, when required
- A UC Santa Cruz “Employee-Vendor Relationship Disclosure Form” must be filled out and approved by the director of Procurement Services when the purchase or rental of goods or services are proposed to be done through a University employee or near relative
- A detailed statement of work

The buyer, who has the delegation of authority to sign the contract, will then review the requisition form, supporting documentation, and correct any issues that need correcting.

They:

- Make the determination whether the contractor is a consultant, in which case Business Contracts will need to complete a consulting agreement. Consultants (001010) have a different account code than contractors (001260);
- Forward to Business Contracts any non-standard supplier terms & conditions for review, and potential addendum, or counter with a UC agreement;
- Negotiate prices, and business terms;
- Ensure the contractor bidding process has been completed if over certain dollar thresholds; and
- Finally, they approve the requisition, generate a purchase order, and attach the signed contract.

From here, the department requestors generally track the completion of work. Initially, requestors generally handle disputes, but Procurement can get involved if necessary.

When work is completed, Financial Affairs, FAST A/P pays the contractor invoice.

Scope

During the audit, we reviewed the means by which the University provides controls over the acquisition of services via the CruzBuy System:

- We reviewed existing formal or informal policies at UC Office of the President, UC Santa Cruz, other UC system campuses, and local division policy
- We interviewed personnel from Financial Affairs and Procurement Services
- We conducted a trend analysis on purchase order data for the period of January 1, 2015 to November 7, 2017 (Over 443,000 lines of data)
- We conducted an in-depth analysis of a sample of 113 purchase orders with account codes 1010 and 1260 (See Appendix A for sample methodology). Within this detailed analysis, we reviewed purchase orders for:
 - Evidence of fraud, waste, or abuse, to include price splitting to avoid particular dollar thresholds, purchase orders made to benefit family members, or sole-source purchase orders without proper justification;
 - Evidence of price negotiation;
 - Necessary documentation is included and properly filled in to include Pre-Hire Worksheets (when required) and Statements of Work; and
 - Accuracy of reported data to include service dates and prices.
- We reviewed actions Procurement Services is taking to reduce the frequency of After the Facts and improve the accuracy and quality of CruzBuy requisitions.

III. OBSERVATION REQUIRING MANAGEMENT CORRECTIVE ACTION

A. After the Fact Requisitions	
While CruzBuy controls appear to be working relatively well to reduce the risk of fraud and waste, After the Fact requisitions bypass many of these controls and are relatively frequent.	
Risk Statement/Effect	
After the Fact requisitions effectively bypass many of the controls Procurement Services have put into place. Without going through their normal controls, Procurement Services will not be able to ensure: <ul style="list-style-type: none"> • The University gets the best deals on services via negotiations with suppliers • Contracts are in compliance with UC policies or state/federal laws • Department do not obligate resources that are not in the best interest of the University 	
Agreement	
A.1	The Procurement and Supply Chain Services will require department heads to sign a justification statement for all After the Fact requisitions. At a minimum these justifications should state:
	Implementation Date
	09/01/2018
	Responsible Manager
a) Why the unauthorized procurement action was taken b) Whether or not the price is considered reasonable and the basis for making that determination c) Actions being taken to preclude any future unauthorized purchases d) Acknowledgement that departments will assume all risks for unauthorized transactions related to insurance, wages, data security breach and intellectual property rights	Director, Procurement Services

A. After the Fact Requisitions

Generally, we found CruzBuy controls within our limited sample to be working relatively well to reduce the risk of fraud, waste and abuse. Specifically, within our sample of 113 purchase orders, we did not find evidence of price splitting to avoid particular dollar thresholds, purchase orders made to benefit family members, or sole-source purchase orders without proper justification. Further, we found clear evidence of price negotiation, consistent use of Pre-Hire Worksheets, and generally timely processing of requisitions.

While CruzBuy controls appear to be working relatively well to reduce the risk of fraud and waste, After the Fact requisitions are an ongoing risk to the University because these requisitions effectively bypass many of the controls Procurement Services has in place. An After the Fact requisition occurs when a department enters into a contract without proper authority and then pushes the invoice to Procurement. Procurement has been delegated the authority to sign goods and services contracts, while most other departments do not have this authority (with a few exceptions such as the Real Estate Office, but this is for real property). There are a few risks when departments engage in After the Fact requisitions:

- The University might not be getting the best deal. Through negotiations, Procurement Services often saves the University money – which they cannot do in an After the Fact (ATF) transaction. Procurement services tracks these ATF requisitions

- The contract might not be in compliance with UC policies or state/federal laws
- The department might obligate resources that are not in the best interest of the University

Procurement Services already takes actions to reduce the frequency of After the Fact requisitions. Firstly, buyers track requisitions which are After the Fact by checking a field in CruzBuy that is normally reserved for tracking benefits derived from contract negotiations (buyers are unable to negotiate better terms with contractors when After the Facts occur). This tracking provides an audit trail that allows the University to understand the magnitude and consistency of the problem. Using this tracking information, we found that during the period of January 1, 2015 to November 7, 2017, a total of 1,161 of 6,058 requisitions (19%) for outside consulting services (account code 1010) and miscellaneous outside services (account code 1260) were considered "After the Facts." We found this trend to be consistent over time and spread throughout many divisions:

After The Fact Requisitions for Services (Sorted by Total Number of Service Requisitions)			
Department	ATF Purchase Orders	Total Purchase Orders ↓	% ATF
Physical Plant	159	886	18%
Physical & Biological Sciences	134	549	24%
Arts	170	540	31%
University Relations	65	503	13%
CUHS	68	464	15%
Social Sciences	125	429	29%
Business and Administrative Services	48	272	18%
SOAR	18	264	7%
School of Engineering	46	244	19%
Retention Services	42	215	20%
OPERS	41	203	20%
University Extension	38	191	20%
Educational Partnership Center	25	157	16%
Information Technology Services	14	117	12%
Campus Life	15	102	15%
Grad Division/Office of Research	16	91	18%
Humanities	12	87	14%
Library	16	76	21%
Enrollment Management	11	65	17%
UCO/Lick Observatory	2	65	3%
College Nine	1	54	2%
Health Center	5	51	10%
Other Departments	90	433	21%
Total for All Departments	1161	6058	19%

Procurement Services also inform requestors and contractors using standard language via email whenever After the Facts occur:

Message sent to the department:

"This request is considered to be an After the Fact (ATF) purchase of goods or services. Purchases made without the prior approval of Procurement Services are considered unauthorized purchases and are a violation of University of California Business and Finance Bulletin 43. Any such negotiations for goods or services are considered unauthorized and the individual placing the request potentially encounters a personal obligation to the supplier. Any time orders for services or materials are to be invoiced to the University a UCSC Purchase Order must be sent to the supplier before the materials are shipped or the services are performed. The UCSC Purchase Order number must be referenced on the invoice for payment. You and your department are responsible for implementing all necessary precautions to prevent occurrences of ATF requisitions in the future. Please forward this information as appropriate. We appreciate your cooperation. Thank you."

Message sent to the Supplier:

"IMPORTANT NOTE TO SUPPLIER REGARDING PROVISION OF GOODS OR SERVICES PRIOR TO RECEIPT OF OFFICIAL UNIVERSITY OF CALIFORNIA PURCHASE ORDER: All University of California purchases require a valid University purchase order PRIOR to the execution of services or shipment of goods. Acceptance of orders without the appropriate purchase order number is done at the supplier's risk. Such orders may result in delayed payment. Your cooperation is appreciated. Thank you."

Procurement Services could further improve transparency over After the Facts by involving departmental leadership when After the Facts occur. UC Berkeley's Supply Chain Management provides one model for doing so. They require departments to fill in an After the Fact Justification form (*See Appendix B*) that requires departments to:

- Describe efforts made to ensure that the prices paid were reasonable;
- Describe efforts made to preclude any future unauthorized purchases; and
- Have the department director sign the form.

This additional control used by UC Berkeley is reasonable and a similar control could be adopted by UCSC. Involving department leadership whenever After the Facts occur could improve controls over contractor requisitions and reduce the frequency of requisitions that avoid procurement controls due to being After the Fact.

B. CruzBuy Documentation and Data Entry		
While CruzBuy controls appear to be working relatively well to reduce the risk of fraud and waste, some data entry errors had occurred. These errors generally appeared to be caused by a lack of knowledge on the part of individuals requisitioning services.		
Risk Statement/Effect		
Data entry errors could reduce the reliability of any analysis performed on CruzBuy requisitions.		
Agreement		
B.1	The Procurement and Supply Chain Services will ensure additional instructions are given during regular updates to service forms for contractors. At a minimum these instructions should include: a) Information (or a reference link to information) that explains the general process for hiring contractors and specifically states that POs need to be complete prior to contractors performing the work b) Additional information on how to make employee/contractor indicator judgments on the current Pre-Hire Worksheet c) Additional information for how to fill in common problem areas such as service date fields	Implementation Date
		09/01/2018
		Responsible Manager
		Director, Procurement Services

B. CruzBuy Documentation and Data Entry

Generally, we found most CruzBuy documentation and data to be reasonably accurate. While we did find some errors, they were not typically consequential. However, any improvements in documentation and data input would be beneficial to improve the reliability of any analysis performed on CruzBuy requisitions.

By far the most frequent error in data entry related to dates when services occurred. Specifically, we found that at least 25% of the dates entered into CruzBuy within our sample were likely inaccurate. Requestors frequently used estimated dates and generally did not update them if conditions changed. However, buyers generally would have little basis to verify these dates. Furthermore, because these dates are not generally used for reporting, and After the Fact requisitions are separately tracked, the risk to the University for having inaccurate service dates are low, and may not warrant the resources to build additional controls except for higher value requisitions.

Another common error was incomplete or improperly filling in Pre-Hire Worksheets. We found 4% of Pre-Hire Worksheets were incomplete (generally from having blank names in the certification box) and 6% had at least one error regarding the characterization of whether an individual should be considered an independent contractor or an employee. For example, some requestors would simply check every item in the “Contractor” column. The most common error was when the Pre-Hire Worksheet indicated that the contractor would be responsible for his or her own travel, while simultaneously the purchase order had travel reimbursement for the

contractor clearly built in. However, none of the errors we found within the Pre-Hire Worksheets were likely to ultimately sway the determination of whether an individual should have been considered an employee or contractor.

We also found other errors:

- 5% of the requisitions we reviewed did not contain an acceptable statement of work. While the requisitions we reviewed without acceptable statements of work were relatively small in cost, statements of work should be included on any service requisition.
- 4% of the requisitions we reviewed had an inaccurate price listed in CruzBuy. Sometimes requestors would enter what seemed to be placeholders and would not update the price later. In other cases, the prices would reflect the pre-negotiated price and the lower price was not reflected in CruzBuy.
- In one case, a purchase order was miscategorized as an After the Fact (when it was not). The purchase order messages between the buyer and requestor showed that this was caused by the requestor mistakenly plugging in a service date prior to when the service would occur.

In summary, we detected the following errors in our sample:

Purchase Order Errors (Of 113 sampled)		
Error	Occurrences	% of Sample
Pre-Hire Worksheet not completed	5	4%
Pre-Hire Worksheet not correctly filled in	7	6%
Did not contain acceptable statement of work	6	5%
Prices in CruzBuy were inaccurate	4	4%
Dates in CruzBuy were inaccurate	28	25%
PO miscategorized as an After the Fact	1	1%

Few of these errors proved to be consequential. However, any improvements in documentation and data input would be beneficial to improving the reliability of any analysis performed on CruzBuy requisitions.

Procurement Services is in the process of drafting a new services form that could give instructions that are more explicit on how to fill in the purchase order, such as the content in the service date fields and Pre-Hire Worksheets, and it could remind the requestor to include all necessary documents, such as the statement of work. Because many of the errors originate from the initial requestor of services, improvement made on information provided to the requestor could improve the quality of their inputs and consequentially, the quality of CruzBuy data.

APPENDIX A – Summary of Work Performed and Results

Preliminary Analysis	
Work Performed	Results
<ul style="list-style-type: none"> We reviewed existing formal or informal policies at UC Office of the President, UC Santa Cruz, other UC campuses, and local division policy. 	<ul style="list-style-type: none"> We found there is a fair amount of guidance for procuring service contractors from various sources to include: <ul style="list-style-type: none"> UCOP policy (i.e. BUS-34, BUS-43, and BUS-77); Campus policy (i.e. MM-0001, MM0002, and MM0003); and The Procurement Services website (containing standard forms, guidance, etc.). We incorporated information from these into a risk matrix and audit program.
<ul style="list-style-type: none"> We reviewed prior reports conducted at UC campuses related to procuring contractors. We interviewed personnel from Financial Affairs and Procurement Services. 	<ul style="list-style-type: none"> We developed a risk matrix and audit program to address the risk areas identified.

CruzBuy – General Analysis	
Work Performed	Results
<ul style="list-style-type: none"> We conducted a trend analysis on purchase order data for the period of January 1, 2015 to November 7, 2017 (Over 443,000 lines of data). 	<ul style="list-style-type: none"> During the period of January 1, 2015 to November 7, 2017, there were 1,161 After the Facts of 6,058 requisitions (19%) for outside consulting services (account code 1010) and miscellaneous outside services (account code 1260). We found this trend to be consistent over time and spread throughout many divisions
<ul style="list-style-type: none"> We reviewed actions Procurement Services is taking to reduce the frequency of After the Facts and improve the accuracy and quality of CruzBuy requisitions. 	<ul style="list-style-type: none"> Procurement Services is in the process of drafting a new services form that could give instructions that are more explicit on how to fill in the purchase order, such as the content in the service date fields and pre-hire worksheets, and it could remind the requestor to include all necessary documents, such as the statement of work.

CruzBuy – Purchase Order Testing	
Work Performed	Results
<ul style="list-style-type: none"> We conducted in-depth analysis of purchase orders with account codes 1010 and 1260. 	<ul style="list-style-type: none"> We created a stratified random sample of 113 purchase orders (see next page) and the detailed results of our analysis is found after this line.
<ul style="list-style-type: none"> We reviewed purchase orders for evidence of fraud, waste, or abuse, to include price splitting to avoid particular dollar thresholds, purchase orders made to benefit family members, or sole-source purchase orders without proper justification 	<ul style="list-style-type: none"> We found no evidence of fraud, waste, or abuse within the sample.
<ul style="list-style-type: none"> We reviewed purchase orders for evidence of price negotiation. 	<ul style="list-style-type: none"> We found clear evidence of price negotiation (when requisitions were not completed as After the Facts).
<ul style="list-style-type: none"> We reviewed purchase orders for necessary documentation and properly filled in to include Pre-Hire Worksheets (when required) and statements of work. 	<ul style="list-style-type: none"> 4% of Pre-Hire Worksheets were incomplete. 5% of the requisitions we reviewed did not contain an acceptable statement of work. While the requisitions we reviewed without acceptable statements of work were relatively small in cost, statements of work should be included on any service requisition.
<ul style="list-style-type: none"> We reviewed purchase orders for accuracy of reported data to include service dates and prices. 	<ul style="list-style-type: none"> At least 25% of the dates entered into CruzBuy within our sample were likely inaccurate 6% of Pre-Hire Worksheets had at least one error regarding the characterization of whether an individual should be considered an independent contractor or an employee. 4% of the requisitions we reviewed had an inaccurate price listed in CruzBuy. In one case, a purchase order was miscategorized as an After the Fact (when it was not). The purchase order messages between the buyer and requestor showed that this was caused by the requestor mistakenly plugging in a service date prior to when the service would occur.

Stratified Sample									
	Acct Code 1010			Acct Code 1260			Total		
	Sample	Population	%	Sample	Population	%	Sample	Population	%
Group 1 (Over \$500,000)	7	7	100%	31	38	82%	38	45	84%
Group 2 (\$95,000 - \$500,000)	9	10	90%	17	84	20%	26	94	28%
Group 3 (\$9,500 - \$94,999)	12	114	11%	17	666	3%	29	780	4%
Group 4 (under \$9,500)	20	264	8%	<i>Did not sample in this range</i>			20	264	8%
Total	48	395	12%	65	788	8%	113	1183	10%

APPENDIX B – Example of UC Berkeley After the Fact Justification Form

UC Berkeley, Supply Chain Management

After-The-Fact Justification for Unauthorized Purchases

This purchase was made without prior Purchase Order authorization. UC Berkeley requires additional justification supporting commitment of university funds for all After-The-Fact purchase requests.*

Instructions: Please complete and upload this document as an Internal Attachment within BearBuy After-The-Fact Form. Requisition/PO Number:

1. Confirm that the department understands their approved procurement delegations are limited to orders ≤\$4999.99 and do not fall into any restricted categories or special considerations as documented on the [Low Value Purchases](#) website. Yes No

2. Describe that the department demonstrated effort to ensure that the price paid would be considered reasonable.

3. Describe that the department has taken the necessary steps to preclude any future unauthorized purchases.

4. Department to assume risks for unauthorized transactions related to liability due to gaps in coverage for; insurance, wages, data security breach and intellectual property rights.

5. The department head is required to sign the justification.

Department Name:

Unit Director Printed Name:

Unit Director Signature (Submitter):

Date:

Dean or VC Printed Name:

Dean or VC Signature (Approval):

Date:

*Please refer to the relevant policy [BFB-BUS-43 Materiel Management](#), Part III, Section G