



INTERNAL AUDIT SERVICES
IRVINE, CALIFORNIA 92697-3625

August 3, 2020

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RE: Fair Wage/Fair Work Audit
Report No. I2019-110

Internal Audit Services has completed the Fair Wage/Fair Work review 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
Peter Cataldo, Systemwide Associate Audit Director - UC Ethics, Compliance &
Audit Services

I. MANAGEMENT SUMMARY

In accordance with the fiscal year (FY) 2019-2020 audit plan, Internal Audit Services (IAS) conducted a review of the Fair Wage/Fair Work (FW/FW) program at the University of California, Irvine Campus and Medical Center (UCI Health). Based on the audit work performed, some internal controls need improvement and should be strengthened to minimize risks, ensure compliance with University policies and procedures, and/or best business practices. Specifically, the following concerns were noted.

Management of FW/FW Leases – The Real Estate Services (RES) department has developed a portfolio summary list of leases where FW/FW may or may not apply at both the campus and UCI Health. However, this portfolio should be reviewed and its controls strengthened to help manage FW/FW requirements by including descriptions on why FW/FW does or does not apply, lease commencement dates, and the status of annual verifications. This is discussed in V.1.

Annual Verification Audit – RES did not collect and receive annual verifications for two leases as required by the FW/FW Plan. Additionally, there is currently no established process to monitor annual verifications or follow-up with tenant(s)/landlord(s) who fail to provide the annual verification. This is discussed in section V.2.

II. BACKGROUND

Procurement

The University of California (UC) President announced at the July 22, 2015, Regents Meeting that a FW/FW program was to be adopted. This program was effective October 1, 2015, for all new agreements and for renewed and extended agreements. The new minimum wage plan for UC employees working at least 20 hours per week and employees of suppliers providing services to UC under this program were to be paid a minimum of \$13 per hour effective October 1, 2015, \$14 per hour effective October 1, 2016, and \$15 per hour effective October 1, 2017. FW/FW does not apply if the agreement:

- Is only for the furnishing of goods;
- Involves services not performed at one or more UC campuses, labs, or medical centers;

- Involves services that are a Public Work with a wage determination *at or above* the UC Fair Wage; and
- Involves services funded by an extramural award containing sponsor-mandated terms and conditions (T&Cs). This includes federal, state or private foundation awards and research grants.

For services that exceed \$100,000 annually, suppliers are required to perform an annual independent audit and verification at the supplier's expense. Suppliers must also ensure its auditor makes its FW/FW work papers available to UC.

Procurement offices will contribute information to the location's database regarding agreements handled by buyers that contain FW/FW provisions and for which an exception has been approved. For service agreements that exceed \$100,000 annually, the Procurement offices are to remind suppliers of the FW/FW audit requirements before the agreement's anniversary date. Buyers should receive verification forms from suppliers and forward a copy of verification to the internal auditor.

Real Estate

Effective May 1, 2016, UC's FW/FW Plan (Plan) establishes minimum wage levels for persons employed by or on behalf of UC. The Plan applies to payment for work performed in a UC location and are deemed to include leased and licensed space whether UC is the Landlord/Licensor or Tenant/Licensee of space, and land ground leased to or from UC, that fall within the following guidelines.

1. Space Leases and Licenses

- a. UC as Landlord or Licensor: Where the tenant or licensee, in UC-owned or controlled space, provides a service or conducts a business that UC otherwise would provide or conduct, and the agreement is for a term of more than one year. Examples include food service, bookstores, and recreational programs. Examples of services and businesses that UC does not typically provide or conduct, and therefore are not required to implement the Plan, include banking, dry cleaners, solar power generating facilities, and cell tower service.
- b. UC as Tenant or Licensee: Where UC as tenant or licensee effectively exercises, or has the power to exercise, control over the operations of a building for a term of more than one year. (i.e., not in multi-tenant buildings)

where the building owner provides services to tenants including but not limited to UC).

2. Ground Leases

- a. UC as Ground Lessor: Any building constructed on UC land pursuant to a ground lease or similar arrangement, where (i) UC leases back at least 50% of the space for the duration of the ground lease (or similar arrangement), or (ii) the building is constructed for a use that supports UC's mission and which could have been constructed and operated by UC (e.g., recreational facilities, student or faculty rental housing, and parking facilities).

- b. UC as Ground Lessee: Any building or other facility constructed by UC or for UC's use.

Exceptions to the Plan include:

- Endowment or investment property; and
- Extramural agreements with sponsor mandated terms.

For any lease, license, or ground lease determined to be covered by the Plan, the applicable lease/license agreement shall include provisions that state that the other party (e.g., lessee, license, 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. The applicable agreement shall further include provisions that allow UC to audit the other party's compliance with the Plan and provide sufficient access to their records for this purpose. If the other party fails to provide annual verification upon audit, the other party shall be deemed to be in default under the terms of the applicable agreement and UC shall be able to pursue appropriate remedies including termination of agreement.

RES is responsible for maintaining an updated list of all leases and licenses that are subject to the FW/FW policy. RES should be able to identify if the FW/FW verification is current for each lease/license subject to the FW/FW policy and to report on the status of efforts to obtain 100 percent compliance for all leases and licenses. Finally, RES must furnish FW/FW information in a timely manner to campus internal audit so that the UC system can promptly report on compliance with the FW/FW policy.

III. PURPOSE, SCOPE AND OBJECTIVES

The purpose of the audit was to assess whether Procurement and RES at both the campus and UCI Health locations have implemented processes to ensure vendor compliance with the FW/FW work plan. The scope included a review of applicable contracts, leases/licenses, and selected transactions for review and testing from January 1, 2019, to December 31, 2019.

The audit included the following objectives:

1. Determine whether applicable procurement contracts for services over \$100,000 and real estate leases/licenses comply with FW/FW requirements;
2. Determine if FW/FW contracts and leases/licenses contain UC T&Cs and provision language, respectively;
3. Verify that RES maintains annual verification documentation for all leases and licenses subject to FW/FW; and
4. Determine if exceptions were adequately managed and approved.

IV. CONCLUSION

As RES is transitioning into the FW/FW Plan, departmental controls and processes could be further enhanced in the areas of ensuring that the lease listings are adequate and contain the information needed to manage FW/FW, and that staff are trained and understand the FW/FW requirements.

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

V. OBSERVATIONS AND MANAGEMENT ACTION PLANS

1. Management of FW/FW Leases (Real Estate)

Background

In order to complete sample testing, IAS requested a listing of contracts and leases with the FW/FW provision and all FW/FW policy exceptions that were executed between January 1, 2019, to December 31, 2019 from Procurement and

RES at both the campus and UCI Health locations. IAS also inquired about the process to ensure completeness of the list.

Observation

Real Estate Services (RES)

Although a listing of leases where FW/FW may or may not apply was provided to IAS, it requires improvement. The initial listing provided by RES did not include a description as to why FW/FW does not apply. In addition, IAS identified two instances where RES mislabeled FW/FW as not applicable when, in fact, it was.

The portfolio summary list provided by RES showing UC as the Landlord did not include lease commencement dates which makes it difficult to manage and determine if FW/FW applies. The lack of this anniversary date also makes it difficult to determine when annual verifications are due. However, the list showing UC as Tenant was complete.

As of this year, the UC Office of the President (UCOP) system-wide FW/FW audit plan included the Real Estate FW/FW applicability component. As a best practice, RES should review all FW/FW guidelines and resources provided by the UC system to better familiarize themselves with FW/FW provisions applicability/requirements. This will also strengthen their controls over the management and monitoring of the FW/FW listings.

Campus Procurement

No issues were noted.

UCI Health Procurement

No issues were noted.

Management Action Plan

Real Estate Services

RES will augment the lease/license portfolio listings to include reasons why FW/FW would or would not apply and include lease effective/ commencement dates. They will create a supplemental report for leases/licenses that require annual verifications, record due dates, and document any follow-up

correspondence to ensure proper management of FW/FW requirements. Listings will be revised by November 1, 2020.

In addition, RES will explore the cost and feasibility of revising the third party lease administration report to include an abstract of the FW/FW clause in existing and future leases. Management will review all applicable FW/FW guidelines and resources within the UC system by November 1, 2020.

2. Annual Verification (Real Estate Services)

Background

According to the FW/FW Plan requirements, tenant(s)/landlord(s) shall provide an annual verification by an authorized representative. The tenant(s)/landlord(s) should ensure that an authorized representative reviews payroll records to confirm FW/FW compliance. These audit results should be documented on an UC FW/FW verification form and sent to RES annually, no later than 90 days after each one-year anniversary of the agreement's effective date.

Observation

Of the one hundred twenty (120) leases/licenses provided to IAS for review, two were applicable to FW/FW and required annual verifications. RES did not request or receive the annual verifications for both of these leases/licenses. The FW/FW plan states that the tenant(s)/landlord(s) shall complete an annual verification form. This form shall be reasonably acceptable to tenant(s)/landlord(s) in form and substance. The form should note the anniversary of each lease commencement date and the tenant(s)/landlord(s) will verify, for the immediately preceding calendar year, that they have complied with the requirements of the plan with respect to their employees and contractors who work more than twenty hours per week in the building.

Furthermore, RES does not currently have an annual verification process in place to ensure verifications are properly managed, monitored, and maintained. To ensure that the FW/FW verification requirements are complied with, RES should:

- Remind tenant(s)/landlord(s) of their deadline to provide annual verification;
- Send follow-up letters once the deadline has passed and if the verification form is not received within three months of the due date, issue a notice of default; and
- Initiate remedies of the lease/license agreement for default due to non-compliance.

As stated in Observation V.1 above, RES should review all FW/FW guidelines and resources offered within the UC system in order to ensure compliance with UC requirements and better familiarize themselves with annual verification processes and procedures.

Campus Procurement

No issues were noted.

UCI Health Procurement

No issues were noted.

Management Action Plan

Real Estate Services

Management will ensure verifications are provided by the tenant(s)/landlord(s) on an annual basis and that these verifications are completed by an authorized representative. If verifications are not received on a timely basis, Management will send follow-up correspondence to the tenant(s)/landlord(s) until an adequate response is received or resolution to the matter is achieved. If exceptions are noted on the verifications, Management will follow-up to ensure the exceptions are resolved adequately, otherwise, the issue will be escalated through the proper channels. These processes will be implemented by November 1, 2020.

Additionally, as mentioned in Management Action Plan V.1 above, Management will review all applicable FW/FW guidelines and resources within the UC system by November 1, 2020 to ensure compliance with the UC annual verification form requirements.