UC MERCED AUDIT AND ADVISORY SERVICES

May 31, 2018

To: Veronica Mendez – Chief Financial and Administrative Officer

Subject: Low Value Purchase Orders and Purchase Cards

Ref: Audit Report No. M18A003

UC Merced Internal Audit has completed an audit of departmental purchasing via Low Value
Orders, Purchase Cards, and "One Time Payee" payments. The scope of the audit included
purchases by 59 different departments at UC Merced.

We appreciate the help we received from staff in Procurement, Accounting Services, and
department purchasers throughout the campus. If you have any questions, please feel free to
contact me.

Todd Kucker
Director of Internal Audit

Attachment

cc   Senior Vice President and Chief Compliance and Audit Officer Bustamante
       Chancellor Leland
       Associate Chancellor and Senior Advisor Putney
       Assistant Vice Chancellor and Controller Riley
       Assistant Controller Groesbeck
       Chief Procurement Officer Dubroff
       Director Riedeman

UNIVERSITY OF CALIFORNIA, MERCED
AUDIT AND ADVISORY SERVICES

Low Value Purchase Orders and Purchase Cards
Report No. M18A003

May 31, 2018

Work completed by:
Todd Kucker – Director

Management Summary

Internal Audit has completed an audit that evaluated decentralized purchasing controls in departments. During the audit, we reviewed the use of purchase cards, low value orders, and "One Time Payee" payments by 59 different departments.

Based upon the testing, we concluded that departments are effectively managing their decentralized purchasing authority and low value purchasing. The Procurement department is currently working to set up a new procurement system and to put new processing workflows in place. These significant changes will impact how departments complete low value purchasing.

We identified some areas for improvement which are discussed in the report below under the following headings:
- Control over gift card purchases
- Restricted items purchased on low value orders
- Inconsistent payment of sales/use tax
- Risk-based procedures related to receiving

Purpose and Scope

Internal Audit has completed an audit of purchase card transactions, low value orders, and "one time payee" payments, which was part of the Fiscal Year 2017 – 2018 Audit Plan. The purpose of the audit was to review that departments were effectively managing their decentralized purchasing authority. The objectives of the audit were:

- To verify that segregation of duties, reviews, and other purchasing controls were properly managed by departments; and,
- To review how the Procurement department is monitoring the purchasing authority that has been granted to departments.

The audit covered purchase card transactions, low value orders, and "one-time payee" payments completed during Fiscal Year 2016 – 2017. During the audit, we tested 179 purchase card transactions totaling $198,637. This large sample included purchases from 68 cardholders representing 33 different departments. We tested 120 low value orders totaling $273,212 completed by department purchasers in 49 different departments. To test one-time payee payments, we identified the 30 recipients who received the largest payments. For all of these sampled purchases and payments, we reviewed the business purpose and approval of the expenditures and verified that the purchases complied with UC policy.

Background

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

Department approvers and the Procurement 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.

Low Value Orders (LVO's)

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

As the UC Merced campus grows, the use of LVO's continues to increase. The table below shows the use of LVO's during recent fiscal years.

	2013 – 2014	2014 – 2015	2015 – 2016	2016 – 2017
Total LVO's	$4,167,416	$4,233,174	$4,210,737	$4,699,444
# LVO's	6,514	6,175	7,055	7,703
Average LVO	$640	$686	$597	$610
Annual % Change in Spend		+2%	(-1%)	+12%
Campus Spend with Vendors/Suppliers **	$49,203,000	$63,175,000	$71,840,000	$68,588,000
Annual % Change		+28%	+14%	(-5%)

[** - This amount of spend with vendors is estimated from the amounts of supplies and materials, and other expenses associated with core activities (non-capital and non-payroll related expenditures) on the annual campus financial statements.]

Often better pricing can be achieved when blanket purchase orders and strategic agreements are negotiated with vendors. Also, there are often more efficient ways to purchase items rather than utilizing LVO's.

Purchase Cards

The UC Merced Procurement department has managed the campus purchase card program since 2012. The use of purchase cards has continued to increase year after year. The annual percentage increase for purchase card spend has outpaced the increase in LVO use and the overall campus spend.

	2013 – 2014	2014 – 2015	2015 – 2016	2016 – 2017
Total P-Card Transactions	$1,036,980	$1,252,312	$1,843,303	$2,287,050
# Transactions	5,014	6,799	8,279	9,920
Average Purchase	$207	$184	$223	$231
# Cardholders	103	121	140	157
Annual % Increase in Spend		+21%	+47%	+24%

While purchase cards provide a more efficient way to purchase low value items, it is important to have effective controls and monitoring in place. With these purchases, there is an increased risk of fraudulent transactions (e.g. personal purchases, phony vendors, etc.). The following table shows some riskier transactions that require close review by the approver.

	2015 – 2016 # Transactions	2015 – 2016 Amounts	2016 – 2017 # Transactions	2016 – 2017 Amounts
Amazon	2,857	$355,092	3,370	$524,608
PayPal vendors	278	$102,748	272	$107,102
Online Storage (DropBox, etc.)	16	$11,153	5	$495
Weekend Purchases	844	$138,963	1,003	$244,644
Total P-card Purchases	8,279	$1,843,303	9,920	$2,287,050

Purchase card transactions with Amazon accounted for 23% of purchases during Fiscal Year 2016 - 2017. One control related to payment cards is to limit spending to particular Merchant Category Codes (MCC's). This control is not effective with Amazon transactions as no matter what is purchased with Amazon shows up under the "Bookstore" MCC. Vendors that utilize PayPal and other payment processors have a higher fraud risk because of the ease of setting up a phony vendor with these services. Purchases of online storage providers like DropBox create the risk that the University could lose control of data as the account is under the particular employee's control.

While the overall spend with purchase cards and the number of purchase cardholders have increased, cardholders in a few departments complete the majority of the purchases.

	2015 - 2016	% of Total	2016 - 2017	% of Total
Schools:				
Engineering	$332,718	18%	$413,865	18%
Natural Sciences	$203,405	11%	$228,614	10%
SSHA	$92,652	5%	$185,674	8%
Total Schools	$628,775	34%	$828,153	36%
Procurement	$352,703	19%	$273,258	12%
Administrative Coordination Team (ACT)	$96,238	5%	$345,067	15%
Student Life	$170,457	9%	$181,786	8%
Top 6 Departments	$1,248,173	68%	$1,628,264	71%
Rest of Campus	$595,130	32%	$658,786	29%

<u>One Time Payee Payments</u>

When it is apparent that a payee will receive one or a small number of payments from the campus, it is often more efficient to utilize the "One Time Payee" function in CatBuy. This enables a payment without formally setting up the payee as a permanent vendor. One Time Payee payments are commonly used to reimburse non-employees for university-related travel and to pay the remaining grant balances to a grantor in instances when grant funds were not completely utilized.

	2015 – 2016	2016 – 2017
Total One-Time Payee Payments	$893,865	$746,658
# Payments	1,526	1,825
Average Payment	$586	$409

One Time Payee payments should be closely monitored as the payee's name does not show up on campus financial system reports. As a result, additional scrutiny is required to identify unusual trends in these payments.

Conclusion

Based upon the testing, we concluded that departments are effectively managing their decentralized purchasing authority and low value purchasing. The Procurement department is currently working to set up a new procurement system and to put new processing workflows in place. These significant changes will impact how departments complete low value purchasing.

We identified some areas for improvement which are discussed below under the following headings:
- Control over gift card purchases
- Restricted items purchased on low value orders
- Inconsistent payment of sales/use tax
- Risk-based procedures related to receiving

Observations and Recommendations

1. Controls over gift card purchases

Gift cards are often used at UC Merced for special awards to students and employees, to help students in need, and to pay human subjects involved with research studies. While there is usually a valid business purpose to purchase gift cards, there is significant fraud risk related to gift cards as they are cash equivalents.

During the last year, Treasury and Tax Services have worked to improve internal controls related to gift cards. The guidance they have provided to departments requires departments to charge gift cards to particular object codes in the financial system (non-cash awards, Human Subjects) so the card purchases can be more easily identified. The department is required to maintain a log to show how the cards are distributed. After distribution, the log is sent to Treasury and Tax Services for their review. There are different requirements for managing e-cards (which are emailed to recipients) and physical cards. Compliance with UC's cash handling policy, BUS-49 "Policy for Cash and Cash Equivalents Received", is required when physical cards are purchased.

During our review of purchase card transactions, we identified a significant amount of gift card purchases. As there is not a good way to identify gift card purchases, we utilized data analytics software to identify round dollar purchases. We then judgmentally selected large round dollar purchases with Amazon, Target, Wal-Mart, and other similar vendors. Using this imperfect method, we identified $49,543 worth of gift card purchases (2% of total purchase card transactions) during Fiscal Year 2016 - 2017.

To determine whether current procedures are being followed, we reviewed the information received by Treasury for the identified gift card purchases. We identified the following issues:

- There is not an easy way to identify gift card purchases on purchase cards and low value orders. We noted various instances where departments did not notify Treasury and Tax Services of the purchases. As a result, there was insufficient review of the gift cards as only the purchaser knew whether all of the cards were accounted for and properly distributed.

- We noted instances where gift cards were charged to object codes for Office Supplies and Event Coordination. Treasury has requested that gift card purchases be recorded to particular object codes as this helps to identify these purchases.

- In one instance $2,450 worth of physical cards were purchased by a department. As physical cards are cash equivalents, UC Policy requires that maintaining this amount of cards should have been stored in a safe.

- In most instances, the purchaser is the only employee in the department involved with purchasing and then managing the distribution of the gift cards. Even though employees in Treasury and Tax Services review a log of the card distribution, they are not in a position to determine whether the distribution appears correct and consistent with the business purpose for the cards.

As controls over gift card purchases are not effective and departmental oversight is lacking, there is the risk that a purchaser could purchase gift cards and then misappropriate a portion of the cards.

We recommend that Treasury and Tax Services collaborate with Procurement to set up procedures to identify all gift card purchases. These departments should communicate to department purchasers and business officers the requirements related to gift card purchases. A log of all purchases should be maintained and Treasury should follow up with departments for reports regarding the distribution of the cards. A Business Officer or supervisor in the department (or the Principal Investigator who requested the gift cards when the cards are used to pay Human Subjects), should review and approve the distribution of the gift cards.

Management Corrective Action

The Procurement and Contracts Division is currently pursuing phase I of the implementation of a new eProcurement solution called Jaggaer which offers significant increases in functionality and control over the current CatBuy Solution. Phase I implementation is for Catalog Ordering Functionality and will result in strategically sourced catalog content being made available to the campus to "shop" from and submit a purchase request which is automatically routed to the appropriate approvers through an automated workflow engine. In this new environment, the pre-approval of purchases based on predetermined workflow rules combined with line item detail visibility of all catalog purchases and a user friendly reporting tool will improvement spend management capabilities and reduce risk.

Specific to approval for gift card purchases and visibility into gift card spend, a gift card catalog focused on eGift Cards will be pursued and implemented in Jaggaer as a campus wide catalog with workflow rules agreed to between Treasury and Procurement. Reporting functionality to see the details for all gift card catalog orders will be available to Treasury to be able to monitor purchasing activity. Departments will be required to utilize the catalog unless they have a compelling business reason as to why they are unable to use the catalog in which case they will need to provide documentation to Treasury for the non-catalog purchase.

In the interim, prior to the implementation of Jaggaer, Treasury will continue to communicate requirements to MSO's and Buyers regarding gift card reporting, and will add the specific issues identified during the audit to the communications. In addition, Treasury will set up a Gift Card Folder in Box to act as a warehouse for gift card purchasers to report activity and upload logs.

Also, Treasury will use Visa's Intellilink software to run reporting and analytics on gift card transactions and use the system to track cases where gift cards have been purchased in order to

document purchaser accountability. This is limited to purchases made with the UC Merced issued US Bank PCards.

For purchases made outside of PCards, Treasury will run the IT created query for Purchase Order's by Object Code, as well as review activity on Post Authorization Notification Mandatory Reviewer Audit Log to identify gift card purchases made.

The interim controls will be set up by July 31, 2018. The rest of the action plan will be completed with the implementation of the new eProcurement solution.

    2.   Restricted items purchased on Low Value Orders

During the testing, we noted various items and services which should not have been purchased with a low value order. The Procurement department has put together a list of "Purchases Requiring Special Approval and/or Restricted from Low-Value Department Orders" which is provided to all department purchasers and is available on the Procurement webpage. The following are some of the items and services incorrectly purchased with LVO's:

- Purchases of chemicals (where review and approval was not requested from Environmental Health and Safety before the purchase);
- Orders over $5,000;
- On-site services;
- Employee expense reimbursements over $500;
- Subscriptions for utilizing Software as a Service (SAAS) systems (UC policy requires additional written assurance related to the vendor's security over the University's data);
- Payments for professional services and consulting; and,
- Rentals of locations and equipment.

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 the lack of ongoing training of department purchasers. 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 Procurement Department conducts monthly meetings to discuss purchasing related topics, but departmental purchasers are not required to attend.

Procurement is currently beginning work on new procurement processes and a new procurement system. Improving workflows and setting up the system to identify when special approvals (from EH&S, IT, and other departments) are required will improve controls and compliance in this area.

Management Corrective Action

Procurement and Contracts will address these issues through the following measures.

- *Maximize the number of catalogs and catalog content available in Jaggaer with the Phase I rollout to drive the maximum number of orders through automated workflow rules to the appropriate approvers. This includes EH&S for chemicals and IT for IT goods and services when required.*
- *Review the restricted commodity list and ensure it is accurate and will redistribute it to all department buyers.*
- *Develop a document to address the frequent issues identified in this audit and distribute it to all department buyers and MSOs.*
- *Create a required re-training for all department buyers to address the highest priority purchases and restrictions and require that a department buyer attend in order to maintain their access to CatBuy.*

The majority of these corrective actions will be completed by July 31, 2018. The rest of the action plan will be completed with the implementation of the new eProcurement solution.

3. Inconsistent payment of sales/use tax

Many items purchased from vendors via the internet require purchasers to accrue sales or use tax. At UC Merced, department purchasers are responsible for correctly accounting for sales/use tax so the accurate amounts are paid to the California Board of Equalization. Periodically, campuses are audited by Board of Equalization auditors who verify that the correct amounts have been paid. The campus could be at risk of additional payments and fines if the tax is not correctly paid.

For items purchased on the internet, department purchasers are required to evaluate whether the correct amount of sales tax has been collected by the vendor. If the correct amount has not been collected, department purchasers set up the tax in CatBuy so the correct amount is ultimately paid to the Board of Equalization.

During the review of purchase card transactions, we reviewed whether sales/use tax was properly handled by department purchasers. Of the 179 transactions tested, sales/use tax errors were noted on 10 transactions (6% error rate). Both overpayments and underpayments were identified. In various instances, the department purchasers incorrectly accrued tax for items which don't require sales/use tax, such as for employee training and for gift card purchases. In these instances, the campus ends up paying more for items and services that was necessary.

We recommend that the campus Tax Analyst and the Controller's Office increase the amount of training and communication regarding sales/use tax requirements to department purchasers and Business Officers.

Management Corrective Action

Tax Services will continue to train purchasers and Business Officers regarding sales/use tax requirements. We will add the specific issues identified during the audit to the existing training materials and will update employees who the requirement will impact.

This action plan will be completed by December 31, 2018.

4. Risk based procedures related to receiving

An important separation of duties control related to purchase card transactions is that an employee other than the purchaser should complete the receiving function. This helps to prevent a purchaser from purchasing personal items which are never received or utilized by the campus. Currently, when supervisors review and approve the month end purchase card statements and receipts, they are certifying that all items were business-related and were received by the university. As the average purchase card transaction was $231, this certification by the reviewer is sufficient in most cases.

During the audit, we noted various purchases in which good business practices would require additional receiving documentation to provide sufficient evidence that the items were received by the campus. The following are some examples:

- Weekend purchases at local stores (Best Buy, Target, Walmart, Home Depot, Lowes, The Apple Store, etc.)
- Thousands of dollars' worth of physical gift cards and movie gift certificates
- Irrigation pipes and gardening tools purchased with grant funding
- Expensive cameras and laptop computers
- Specialized equipment purchased on eBay
- Clothing purchased at department stores

It is important that the cost of performing a control does not exceed the benefit received. The campus is currently improving controls related to theft sensitive equipment which will help to confirm that purchased equipment is received by the campus. Also, based upon the issue noted during this audit, control over gift cards and gift certificates will be improved. We recommend that Procurement work with department purchasers and Business Officers to establish risk-based guidance when additional documentation should be obtained to certify that items were received.

Management Corrective Action

Procurement and Contracts will:

- *Work to maximize catalog content in phase I of Jaggaer to cover the most common purchases and work to adopt their use so that appropriate pre-approvals occur and line item reporting detail into each transaction is available.*

- *Will work to reduce overall pcard usage and the total number of pcards on the campus by encouraging adoption of catalog ordering.*
- *Will identify items that should be restricted from pcard purchase in favor of a catalog order i.e. high value and other sensitive or unique items available on a catalog.*

Treasury & Banking will:

Use Visa's Intellilink software to run reporting and analytics on PCard transactions and use the system to track cases where restricted items have been purchased in order to document cardholder accountability.

The majority of the corrective actions will be completed by July 31, 2018. The rest of the action plan will be completed with the implementation of the new eProcurement solution.