December 20, 2013

VICE CHANCELLOR REESE

Subject: Audit Report No. M14A002 Purchasing

Attached is the final report for Audit No. M14A002: Purchasing. 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 during the audit. If you should have any questions, please feel free to contact me.

Todd Kucker
Internal Audit Director
UC Merced Internal Audit Services

Attachment

cce: SVP Vacca
     Chancellor Leland
     Interim Assistant Vice Chancellor Riley
     Executive Director Deegan
     Risk Manager Castillo
UNIVERSITY OF CALIFORNIA, MERCED
INTERNAL AUDIT SERVICES

Purchasing
Report No. M14A002

December 20, 2013

Work Performed by:
Todd Kucker, Internal Audit Director
Management Summary

As part of the Fiscal Year 2013-2014 audit plan, we have completed an audit of Purchasing. Based upon the results of the work performed during the audit, we concluded that the Purchasing Department’s system of internal controls is operating satisfactorily and generally in compliance with University policies and procedures.

We noted the following positive observations.

- During the review, we surveyed Management Service Officers (MSO’s) and department purchasers. Overall, employees were satisfied with the support and expertise they receive from the Purchasing Department and many responded with particular instances where purchasers went out of their way to help them.

- Purchase Order files were well-organized resulting in an efficient review of purchase requisitions, competitive bidding, and approval of purchases.

- Purchasers are knowledgeable of UC policies and review purchases to verify that purchasing policies are followed.

We observed some areas that need enhancement to strengthen internal controls and/or effect compliance with University policy:

- Additional procedures should be implemented to identify potential conflicts of interest
- Processes for reviewing and updating Certificates of Insurance should be improved
- Background checks should be completed for contractors filling sensitive positions
- Purchases in violation of policy should be reported to the Ethics and Compliance Program Management Council
- Segregation of duties related to vendor masterfiles should be improved
Purpose and Scope

As part of the Fiscal Year 2013-2014 audit plan, Internal Audit has completed an audit of Purchasing. The purpose of the audit was to evaluate the adequacy of internal controls related to purchase order processes and practices. Where applicable, compliance with University policies and procedures, and other regulatory requirements was also evaluated.

The scope of the audit focused on evaluating UC Merced Purchasing Department controls over campus purchasing activities. This involved interviewing Purchasing Department employees, evaluating purchase processing procedures, assessing policy compliance controls, and reviewing selected document files and information in the campus purchasing system, CatBuy.

A sample of 75 purchase orders totaling $9,179,707 in effect during Fiscal Year 2012-2013 was selected which included amounts charged to the majority of campus departments at UC Merced. Low value purchase orders and other orders handled by department purchasers were not included in the testing. Also, purchases for major and minor construction projects and building leases were not included as the authority for these purchases and agreements has been delegated to other departments. The purchase orders were reviewed for the following:

- Existence of justification of vendor selection and price reasonableness
- Evidence of negotiation between the purchasers and vendors on pricing
- Evidence of locating other possible vendors
- Evidence of potential conflicts of interest

Background

The primary objective of the UC Merced Purchasing Department is to obtain the highest quality goods and services for the best price for the campus, in compliance with applicable laws and University procurement policies. A combination of UC and UC Merced policies govern the processes and procedures for procuring goods and services. These include Business and Finance Bulletin BUS-43 Materiel Management, and the UC Merced Campus Purchasing Policy.

The UC Merced Purchasing Department is comprised of approximately seven employees, which includes the Executive Director (Business Partner) and five buyers. Purchase requisitions are assigned to buyers based on commodity. During June 2012 through May 2013, UC Merced spent $142,523,075 on purchases from 2,371 suppliers. 26,629 purchase orders were issued by the Purchasing Department and department purchasers.

During 2013, the Purchasing Department was awarded the 18th Annual Achievement of Excellence in Procurement Award (AEP) from the National Purchasing Institute (NPI). The award recognizes organizational excellence in procurement by measuring innovation, professionalism, e-procurement, productivity, and leadership attributes of the procurement function. For 2013, UC Merced was one of seventeen higher education institutions in the nation to receive the award.
Conclusion

Based on the results of the work performed, we concluded that the Purchasing Department’s procedures incorporate an adequate system of controls. However, there are some practices that should be implemented or enhanced to ensure that controls function effectively. The following areas for potential improvement were identified.

- Additional procedures should be implemented to identify potential conflicts of interest
- Processes for reviewing and updating Certificates of Insurance should be improved
- Background checks should be completed for contractors filling sensitive positions
- Purchases in violation of policy should be reported to the Ethics and Compliance Program Management Council
- Segregation of duties related to vendor masterfiles should be improved

Observations and Management Action Plans

1. Additional procedures should be implemented to identify potential conflicts of interest

During the review of purchase orders, information related to vendors and independent contractors was compared with employee information to identify potential conflicts of interest. For the 75 purchase orders reviewed, we noted the following potential conflicts.

- One independent contractor had the same address as the employee requesting the service. The Purchaser identified this potential conflict.
- One independent contractor had the same address as a UC Merced faculty member. The contractor did not disclose that he was related to a UC Merced employee.
- Owners of a small company were former graduate students and former employees at UC Merced. One of the owners had been an employee less than a year before entering into business with the University. This issue was identified by Purchasing who sought the guidance of campus counsel prior to executing the contract.

After identifying these potential conflicts of interest, we used data analytics software to match up employee addresses with all current vendor addresses. Various other potential conflicts of interest were identified and further reviewed.

Currently, the only process for identifying potential conflicts of interest is requesting vendors, independent contractors, and employees to disclose potential conflicts of interest.

We recommend that continuous monitoring procedures be set up to proactively search for potential conflicts of interest. Data analytics software could be utilized to periodically compare vendor and employee information.

Management Action Plan

Purchasing will work with Internal Audit to utilize data analytics software to periodically monitor for potential conflicts of interest. While the analysis will cover all vendors, it will focus
on vendors set up and changes to existing vendors during the month. Purchasing will follow up on the potential conflicts of interest identified during the monthly reviews.

The action plan will be implemented by March 1, 2014.

2. Processes for reviewing and updating certificates of insurance should be improved

BUS-63 Insurance Requirements and Certificates of Insurance is the UC policy which outlines insurance requirements for vendors and independent contractors. A certificate of insurance is a document that provides evidence that an individual or entity had adequate insurance coverage in force to protect the interests of the University (and other parties when necessary).

During the audit, we reviewed purchases from vendors and independent contractors to determine whether sufficient evidence of adequate insurance coverage was requested by Purchasing. We noted the following.

- Certificates of insurance are usually issued for one year. We noted instances where the certificate was obtained from vendors which covered the beginning of the work completed by the contractors. The work from the vendor lasted longer than a year and an updated certificate of insurance was not obtained from the vendor. As a result, it was not confirmed that the vendor continued to maintain adequate insurance.

- We noted an instance where a certificate of insurance was not signed by the authorized representative. Without this signature, there is not certification that the listed insurance is in effect.

- Various instances were noted where additional insured endorsements were not obtained from the vendors. The local risk management office recommends obtaining this additional form to prevent the risk of the insurance not properly covering the University.

- Instances were noted where evidence of the correct types of insurance were not confirmed. In one case the certificate did not provide evidence that workers compensation insurance had been obtained by the vendor. In another case, the certificate explained that professional liability insurance had been obtained, but general liability insurance should also have been provided.

- We noted certificates where the “Regents of the University of California” were not listed as the certificate holder.

BUS-63 requires the following: “The Chief Risk Officer (or designee) will periodically audit and review Certificates of Insurance issued on behalf of or to the University of California, including terms and conditions for any exceptions made by the local Risk Management Office.”

Currently, Certificates of Insurance are maintained in the paper Purchase Order files and as pdf’s on a Purchasing shared drive. There is not a formal system to organize and compare the
Certificates of Insurance that have been received with the timing of the work completed by vendors and contractors.

We recommend that Purchasing implement a systematic process for reviewing certificates of insurance to verify that the information is correct and verifying that updated certificates are obtained when certificates on file expire. This will enable efficient review of the certificates by Purchasing and by the Risk Management Office.

**Management Action Plan**

Purchasing will work with the Risk Management Office to come up with a way to track insurance expirations so both groups can periodically review insurance information and procedures.

The action plan will be completed by July 1, 2014.

3. Background checks should be completed for contractors filling sensitive positions

UC policies related to Information Technology security (IS-3 *Electronic Information Security*) and Human Resources (PPSM-21 *Appointment*), and local UC Merced campus procedures outline certain “sensitive positions” which require criminal background checks. During the audit, we noted independent contractors who work in these same types of positions and fulfill the same responsibilities for which background checks were not completed. These positions included information systems personnel and programmers with direct access to and/or responsibility for protected, personal, or other sensitive data.

Recent legislation has increased the scrutiny over individuals who work with minors. We noted instances where campus programs pay independent contractors to work with students at high schools and junior high schools and with migrant children. Background checks on these independent contractors were not completed.

We recommend that background checks be completed for independent contractors with access to sensitive information and for those who work with minors.

**Management Action Plan**

While background checks are the responsibility of the departments that hire independent contractors, Purchasing will add questions to the independent contractor pre-hire checklists which will identify the situations where background checks are required. During the review of the contractor checklists, purchasers will review that departments are aware of background check requirements. Purchasing will also add the background check requirements to the training for department purchasers.

This action plan will be completed by March 31, 2014.
4. Purchases in violation of policy should be reported to the Ethics and Compliance Program Management Council

During the audit, we noted various unauthorized purchases. Of the 75 purchase order selected for testing, four (5%) of the purchases were unauthorized purchases. Unauthorized purchases are purchase transactions that are either entered into by an individual that is not authorized to contract on behalf of the University, or entered into by an individual normally authorized to contract, but who uses an unauthorized procurement method, or exceeds their delegated authority. In all instances, the Purchasing Department correctly required the employee to fill out an “After the Fact” purchase form which was approved by the employee’s manager.

We also noted a purchase where an unauthorized employee committed the University to a purchase by signing a contract before the Purchaser became involved in negotiations with the vendor. During the review of Certificates of Insurance, we noted instances where departments purchased services from independent contractors which should have been handled by the Purchasing Department as risks and special approvals were involved.

Risks related to unauthorized purchases include improperly committing the University to purchase transactions and insufficient consideration of risks related to items or services purchased.

We recommend that information about unauthorized purchases be periodically reported to the Ethics and Compliance Program Management Council. This committee can then monitor risks related to unauthorized purchases and report to campus leadership if trends and excessive risks are identified.

Management Action Plan

Purchasing currently maintains a listing of all unauthorized purchases as they are identified. This listing, along with an overview of the risks related to the unauthorized purchases, will be provided to the Ethics and Compliance Program Management Council so they can periodically evaluate campus compliance with the purchasing policies.

This action plan will be completed by January 31, 2014.

5. Segregation of duties related to vendor masterfiles should be improved

During the audit we reviewed segregation of duties related to the purchasing function. We noted that the employee who reviews new vendors and changes to existing vendors has the ability to set up and make changes to vendor masterfiles in the CatBuy system. As a result, changes to vendor masterfiles by this employee would not be properly reviewed and approved by another employee.
We recommend that CatBuy access be changed so this employee does not have this ability to make changes to vendor files or another employee without the access should be given the responsibility to review and approve these changes.

Management Action Plan

Purchasing will improve the segregation of duties by removing the employee’s ability to set up new vendors and make changes to existing vendors. All changes to vendor information will continue to be reviewed and approved by purchasing management.

This action plan will be completed by January 31, 2014.