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Sheryl Vacca
SENIOR VICE PRESIDENT
CHIEF COMPLIANCE AND AUDIT OFFICER

June 21, 2016

DIRECTOR DIAZ

RE: Final Report Project No. P16A002: ANR Desert Research and Extension Center

Attached is a copy of the final report for: Audit No. P16A002 ANR Desert Research and Extension Center. With the issuance of this final report, please destroy any previous draft versions. We very much appreciate the assistance provided to us by you and members of your staff during our review. If you should have any questions please feel free to contact me at 510-987-9646 (email: matthew.hicks@ucop.edu).

A handwritten signature in black ink, appearing to read "Matt Hicks".

Matt Hicks
Systemwide Deputy Audit Officer

Attachment

cc: Senior Vice President Vacca
Controller McGuire
Systemwide Audit Manager Cataldo
Manager of Financial Services Yu
REC System Business Officer Driskill
REC Superintendent Miramontes
Contractor Schneider
Contractor Berchtold
Contractor Ramirez

UNIVERSITY OF CALIFORNIA
ETHICS, COMPLIANCE AND AUDIT SERVICES
OFFICE OF THE PRESIDENT
INTERNAL AUDIT SERVICES

ANR DESERT RESEARCH AND EXTENSION CENTER
Audit No. P16A002
April 2016

Audit Conducted by:
Laura Schneider, Contractor
Julia Berchtold, Contractor
Gustabo Ramirez, Contractor

Executive Summary

Introduction

The Agriculture and Natural Resources (ANR) division of the University of California operates the state’s largest research management system for agriculture and natural resources. The system consists of nine Research and Extension Centers (RECs) that support education and research programs in agriculture, natural resources, and human resources throughout the state of California. ANR manages research projects and conducts programs focused on regional agricultural and environmental issues in both rural and urban areas. The RECs have the land, facilities, equipment, and staff to advance the research and educational programs that are being conducted to promote various agricultural initiatives.

Originally named Meloland Field Station and later called the Imperial Valley Field Station, the Desert Research and Extension Center (DREC) was established in 1912 and has grown from 10 to 255 acres. The DREC was established through the cooperative efforts of the University of California, interested citizens, growers, and the Imperial County Board of Supervisors. Located in Holtville, California, the DREC's primary research areas include desert agriculture, field crops, alfalfa breeding, vegetable crops, livestock environmental and feedlot management, irrigation and drainage management, and pest management.

DREC business activities are initiated at the Holtville location by two financial administrators with oversight from the REC Business Officer. Information is processed at the DREC through the financial system, Quali, and submitted to applicable UC Davis departments for issuance and posting as appropriate. DREC business activities follow protocols and policies developed by UC Davis.

Objectives and Scope

As part of the fiscal year 2015 – 2016 annual audit plan, Internal Audit performed a review of the DREC. The audit objectives were to a) evaluate adherence of DREC in-scope business processes to UC Davis policies and procedures and b) identify process improvement opportunities.

The audit scope included the following business processes at the ANR Desert Research and Extension Center:

| | | | |
|---|------------------|---|-------------------------------|
| ✓ | Accounts Payable | ✓ | Financial Management |
| ✓ | Purchasing | ✓ | Rate & Recharge |
| ✓ | Cash Collections | ✓ | Sales, Service & Other Income |

The review included activities performed between January 1, 2015 and December 31, 2015.

To accomplish the project objectives and scope as documented above, Internal Audit performed the following procedures:

- Conducted meetings with key ANR and DREC personnel to determine in-scope business processes.
- Performed a risk assessment of each in-scope business process against several risk factors, including likelihood of error, history of ineffectiveness, and impact to ANR financials.
- Obtained relevant UC Davis and DREC policy and procedure documentation to gain an understanding of in-scope business processes.
- Based on the risk assessment results and documentation obtained, we developed an audit program to evaluate the effectiveness of high risk business processes.
- Evaluated a sample of transactions processed at the DREC for each in-scope business process to assess adherence to UC Davis policies and procedures and timeliness of business activities.
- The following policies and procedures were evaluated for adherence during this review: UC Davis Purchasing, Independent Contractor Agreements and Invoice Processing, Guidelines for Rate & Recharge, and Cash Receipts, Collection of Cash and Depositing Cash at Bank Procedures.

Conclusion

Based on the audit steps performed, ANR Desert Research and Extension Center personnel generally have a detailed understanding of key business activities and UC Davis policies supporting the various business processes. Staff members have an understanding of their responsibilities, and roles within the DREC appear to be appropriately segregated among two financial administrators and the Business Officer. In our review of business activities for three of the six in-scope business processes, Internal Audit noted DREC activities were performed effectively in accordance with UC Davis policy.

We noted opportunities for improvement within the purchasing and accounts payable processes related to departmental purchase order and invoice approval and invoice processing. In addition, we noted opportunities for improvement within the rate and recharge process related to timely and accurate recording of recharge activity.

Actions developed by the DREC will strengthen business processes and increase effectiveness of operations.

Opportunities for Improvement and Management Action Plans

1. Non-adherence to DREC Purchasing Procedures

For 3 of the 25 purchases selected for testing, we noted the Departmental Purchase Order Form or invoice was not processed in accordance with the Desert Agricultural Research & Extension Center Purchasing Procedures.

- For 2 of 25 purchases selected (invoices of \$140.00 and \$2,090.00), the Departmental PO forms were not approved until after the order had been placed.
- For 1 of 25 purchases selected (invoice of \$15,375.00), evidence of approval by an authorized approver was not apparent via sign-off on the invoice.

According to the Purchasing, Independent Contractor Agreements and Invoice Processing Procedures, Departmental Purchase Order Forms must be completed and approved prior to purchase. Additionally, invoices must be approved by an authorized approver prior to initiation within the Kualu system. Authorized approvers per the procedures include the REC Superintendent, REC Director, and Business Officer.

In discussions with the Business Officer, we noted the issues resulted from a transition in leadership within the REC. These invoices were processed at a time when the interim REC Director spent a significant amount of time off-site and was consequently not available for timely invoice approval. This has since been addressed by the hiring of a full-time REC Director on site.

Management Action Plan:

The Desert REC Business Officer and Director have agreed to revise the Departmental PO initiation and purchasing approval process effective March 14, 2016. A new Departmental PO form has been created and updated to ensure timeliness, completeness, and proper approval of REC purchases. Departmental POs will still require approval by an authorized individual (Business Officer, REC Superintendent, or REC Director) prior to purchase, however the updated procedures specify protocols for obtaining remote Departmental PO and invoice approval when an authorized approver is not available on-site at the REC. In the case of an emergency order, the purchaser must contact the approver via phone and obtain verbal confirmation of the purchase, after which an email must be sent confirming approval by the authorized approver.

Target Date: Revised Departmental PO form and procedures implemented on March 14, 2016, prior to issuance of report.

2. Untimely Invoice Payment

We noted 5 of 25 invoices selected for testing were not paid until after the invoice was due. The late invoices were due to delays in activities at the REC, including late approval

of invoices prior to submitting to UC Davis for payment. These delays resulted from authorized approvers being out of the office (one instance), ongoing negotiations with the vendor (two instances), or misfiling of paper invoices (two instances).

Management Action Plan:

The Business Officer and administrative staff have agreed to contact all vendors to request submission of invoices either via fax or email to avoid late or misdirected invoices. A list has been produced of all active vendors and each vendor will be notated with the submission method agreed to by the vendor to ensure more timely receipt and processing of invoices. Electronic submission of invoices will facilitate electronic tracking to reduce processing delays.

The revised Departmental PO initiation and purchasing approval process effective March 14, 2016 includes procedures for obtaining remote invoice approval in the event authorized approvers are out of office (Refer to Action Plan #1 for additional detail).

Target Date: Action completed in March 2016 prior to issuance of report.

3. Manual Entry Errors of Timesheet Data Used for Recharge Invoices

For 1 of the 5 monthly recharge income invoices selected for review, we obtained a large number of the underlying monthly timesheets for testing. Out of all the timesheets reviewed, we noted one error in entering employee timesheet data into the Labor Database that is used to generate invoices for recharge activity. We noted two (2) hours from a Contract Laborer timesheet for project 30-099 on 11/19/15 were not accurately entered into the Labor Database. The two (2) hour discrepancy resulted in \$38.06 in recharge income not invoiced by DREC.

Per inquiry with the Business Officer, hours are manually entered in the Labor Database on a weekly basis based on worker timesheets. A review of the Labor Database is performed weekly by the administrative staff to verify completeness and accuracy of employee hours and reasonableness of project hours. We noted the detail review of hours performed only includes DREC employees, not Contract Laborer, therefore the two (2) hour discrepancy was not identified during review.

Action Plan:

DREC management has agreed to perform a reconciliation for Contract Labor hours entered in the Labor Database against worker time cards on a weekly basis to ensure all hours have been entered into the Labor Database.

Target Date: Action completed in March 2016 prior to issuance of report.

4. Incorrect Posting of Recharge Income Activity

We noted 2 of 5 recharge income transactions selected for testing were not invoices issued by the REC to researchers, but instead were General Error Corrections (GEC) made to reclassify the transactions. The GEC transactions, \$6,023 and \$10,822.76 respectively, were posted in November 2015 to reclassify income entries from July and August 2015. These transactions were incorrectly recorded to the sub-account designated for FY15 recharge income rather than FY16 as the recharge activity occurred in FY16.

The error was identified during an ad hoc review in November 2015 and not at the time of the initial invoicing or during monthly ledger review. During the audit, the REC Business Officer further determined that a portion of the recharge income actually needed to be reapportioned back to the FY15 account and reclassified the income accordingly. Failure to identify coding errors during reviews of general ledger (GL) transactions by the Financial Administrators and DREC Business Officer can lead to the misallocation of recharge income within the GL.

In discussions with the Business Officer, we noted that the GEC transactions to correct inaccurate posting of recharge income ultimately resulted from untimely setup of University accounts in Quali for the corresponding research projects. University accounts are requested by Principal Investigators (PIs) and approved at UC Davis for use by the REC to invoice rate and recharge activity for each research project. At the time the hours were incurred, the University account for the specific project had not yet been created so the DREC was unable to invoice timely. The delay in invoicing resulted in the income being recorded to the FY16 account based on the time of invoicing rather than the FY15 account based on when the hours were incurred.

As University account setup does not consistently occur at the project start date, recharge hours related to a research project can be incurred by the REC with no corresponding account to invoice. Consequently, late creation of University accounts can result in delays in invoicing for recharge hours by the REC and increase the potential for error as invoicing and invoice review can occur months after the labor hours were incurred by the REC.

Action Plan:

As setup of University accounts is processed by UC Davis, the REC does not have the ability to create University accounts when needed. To monitor late charges (recharge hours incurred by the REC but not yet invoiced due to no University account for the associated project), the DREC uses an internally maintained tracker. The DREC agrees to increase the level of precision used in reviewing all late charges at the time of invoicing to increase accuracy of these transactions. As the review for late charges often occurs months after the initial activity due to the delay in creating the University account, increased levels of review during invoicing may be required to confirm accuracy. To facilitate this review, the Business Officer and administrative staff have agreed to:

- *Implement additional recharge invoice review procedures including an initial detailed review by the Accountant of account coding, both primary and sub-account, and a secondary review by the Business Officer for all internal billing (IB) transactions in Kualu. Transactions coded as IB include all recharge income as well as other income and expenses entries.*
- *Review and subsequently post independent of other recharge activity all late charges resulting from a delay in University account setup to increase accuracy of GL posting of such transactions.*

Target Date: *Action completed in March 2016 prior to issuance of report.*

Additional Recommendations

Internal Audit recommends management consider the following additional improvement opportunities to better align with leading operational practices.

1. Period-End Close Procedures

We confirmed that new period end ledger review procedures in Quali were implemented by UC Davis in July 2015. The new ledger review procedures require the REC Business Officer to complete both the Analytical Ledger Review and Management Ledger Review within 60 days after fiscal month-end. ANR should consider shortening the timeline for ledger review (for example, to 30 days), especially around quarter end, to help ensure any potential issues are identified and resolved timely.

2. Lack of Formal Procedures to Determine Eligible Recharge Expenses

The DREC does not have a consistent or documented method for identifying which expenses should be charged to the rate and recharge account. Per discussion with the Business Officer, each expense is assessed as non-recharge or recharge based on follow-up with the individual purchasers or via knowledge of the specific transaction. While UC Davis Guidelines for Rate & Recharge are used for recharge expenses and no issues were identified during detailed testing, the DREC should consider opportunities to formally document the process and criteria for identifying expenses that should be coded to recharge accounts to streamline the process and promote consistency.

This issue has been addressed through changes to the Departmental PO initiation and purchasing approval process effective March 14, 2016. (*Refer to Action Plan #1 for additional detail.*) Specifically, as part of the revised purchasing process, all purchasers must contact Business Office personnel (administrative assistants or the Business Officer) to describe the intended purchase. Fields within the new version of the Departmental PO form completed by the Business Office include:

- Vendor
- Description of Purchase
- Estimate of expense total
- Purpose (i.e. Research, Administration, Feed Lot, Facilities, Residences, Coop, Farm Smart, Director's Research)

Only purchases categorized with a purpose of "Research" will be eligible for posting to the rate accounts. This will ensure the DREC has a consistent method for identifying which expenses should be charged to the rate account.

Additionally, the REC Business Officer indicated that a document is in development to assist Business Officers across all RECs to help define transaction posting criteria. This

document will list each legacy account, corresponding local account, and respective sub-accounts under the local accounts, including all rate and recharge accounts. The REC Business Officer has agreed to update this document to specifically indicate activities not eligible for posting to the rate account. This document will then be distributed to other RECs to ensure consistency throughout the ANR REC system.