January 28, 2013

VICE CHANCELLOR MILLER

Subject: Final Audit Report No. M13A002
                Departmental Financial Procedures

Attached is the final report of the Departmental Financial Procedures Audit (No. M13A002).
Three separate reports will be issued from this audit. This report relates to the review of
departmental control over assets and financial information in sub ledgers. This report includes
action plans that were developed by members of your staff. These action plans will be entered
into the TeamCentral Database and monitored until completion. With the issuance of this final
report, please destroy any previous draft versions.

I appreciate the assistance provided to me by your staff during the review. If you should have
any questions, please feel free to contact me.
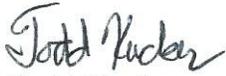
Todd Kucker
Internal Audit Director
UC Merced Internal Audit Services

Attachment

cc: SVP Vacca
        Chancellor Leland
        Assistant Vice Chancellor Ahmed
        Director Deegan
        Director Groesbeck
        Director Toth
        Equipment Manager Callaway

UNIVERSITY OF CALIFORNIA, MERCED
INTERNAL AUDIT SERVICES

Departmental Financial Procedures
Report No. M13A002

January 28, 2013

Work Performed by:
Todd Kucker, Internal Audit Director

Purpose and Scope

Internal audit has completed an audit of departmental financial procedures, which was part of the fiscal year 2013 audit plan. Three separate reports were issued from this audit. This report relates to the testing of the following audit objectives:

- Determine whether departments properly safeguard University assets; and,
- Determine whether financial information maintained by departments in sub ledgers is accurate.

The audit focused on assets included on the University's asset listing as of June 30, 2012 and items purchased during fiscal year 2012. We reviewed how departments maintain control over inventorial equipment, "theft sensitive" equipment, computers, and other valuable supplies. The audit did not review control over items for resale at the campus store and lab supplies and chemicals as these are scheduled to be reviewed during other FY 2013 advisory services.

The audit also identified sub ledgers maintained by departments and reviewed financial procedures in place to verify that the information is accurate. A sub ledger is where financial information is maintained in a separate system from the University's financial system. Departments maintain the financial information in a sub ledger system which is provided to Accounting Services to record the information in the financial system. Sub ledgers include systems used by departments to keep track of inventories and systems used to record fees for services.

Background

Business and Finance Bulletin BUS-29: "Management and Control of University Equipment" establishes requirements for the prudent management and control over the University's property and equipment. The University capitalizes assets with an original cost of $5,000 or more. To maintain control over this "inventorial" equipment, asset tags are affixed to the equipment, information related to the equipment is included on the University's asset listing, and the equipment is assigned to a department custodian.

During early 2012, the University hired its first full-time equipment manager to control inventorial equipment. Until that time, this responsibility was only part of another employee's responsibilities. The equipment manager reports to the campus Materiel Manager, the Director of Purchasing. The equipment manager's responsibilities include: working closely with department asset custodians to maintain the University's asset listing, assigning asset tags for new inventorial equipment, completing a biennial inventory of all of the University's assets (scheduled to be completed during December 2012), and managing the disposal of surplus equipment.

Some items purchased for less than $5,000 are classified as "theft sensitive" items. While these items are expensed, they are subject to inventory control procedures although they

are not maintained on the asset list maintained by the equipment manager. Per BUS-29, departments are responsible for maintaining control of these items.

Another UC Policy related to how departments maintain control over items is Business and Finance Bulletin BUS-54: "Operating Guidelines for University Supply Inventories". This policy outlines operating guidelines for departments if they maintain inventories worth more than $50,000.

Conclusion

Based upon the review, we concluded that departments maintain adequate control over inventorial assets. Control over computers, theft sensitive items, and other valuable supplies could be improved. We noted the following areas for improvement:

Areas for improvement:
- Controls should be added to verify that asset tags are affixed to assets in a timely manner
- Department asset custodians should make timely updates to assets to keep the University asset listing up to date
- Security over computers and theft sensitive equipment should be improved
- Utilizing a specialized system designed for asset tracking could improve control over assets
- Inventory controls over Facilities' spare parts should be implemented

Observations

1. Controls should be added to verify that asset tags are affixed to assets in a timely manner

During the audit, we reviewed procedures for adding inventorial assets to the University's asset listing. We noted that department asset custodians do not always affix asset tags to inventorial assets soon after assets are received.

Asset tags are affixed to assets to maintain control over the assets and to identify that equipment is owned by the University. In the past, the department that maintained control over the campus asset listing identified inventorial assets after the payment was recorded in the financial system rather than when the equipment was received. As a result, there were sometimes delays in sending asset tags to asset custodians and a delay in adding the asset information (serial number, location of the asset, etc.) to the University's asset listing. As asset tags were sometimes received weeks after assets arrived on campus, it was sometimes difficult to locate assets. Instances were noted where asset custodians decided to wait until the next biennial inventory before locating the asset and affixing the tag.

The equipment manager now attempts to provide asset tags and obtain asset information soon after assets are received. As the receiving department is part of Facilities rather than Purchasing at UC Merced and is physically separated from the location of the equipment manager, the equipment manager monitors the receiving system to identify when assets arrive.

Identifying capitalizable expenditures at the time of payment sometimes caused other confusion. Asset custodians mentioned instances where tags were issued for expensive small components of a larger piece of equipment. Asset custodians are uncertain whether to affix tags to small component parts.

As asset tags are not affixed to assets in a timely manner and information such as asset location is not quickly identified and tracked, the risk that the asset could disappear increases. Also, waiting until the next biennial inventory to locate the asset creates inefficiency for the asset custodians as it is usually more difficult to locate assets after more time has passed.

The equipment manager should periodically verify that asset tags have been affixed to recently purchased assets. As a part of the next biennial inventory, the equipment manager has already planned to complete random audits of inventorial assets to verify that asset custodians have properly affixed asset tags and can locate the assets.

Management Action Plan:

Equipment Management will revise the property tag issuing procedure to provide equipment custodians tags upon receipt of equipment, rather than requiring the custodians to provide equipment information prior to issuing tags. This will allow the custodians to apply the property tag as they collect the information required for the equipment records, thus reducing the amount of time required to look for assets. Some departments have already been converted to this new process. This procedure was tried in the past, and often the equipment custodians failed to provide information to equipment management, did not apply the tag to the equipment, and frequently lost the property tag. These challenges will be addressed by providing periodic review to verify that asset tags have been affixed to recently purchased assets.

This action plan will be completed by February 1, 2013.

To verify that asset tags have been affixed to recently purchased assets, the Equipment Manager will make departmental visits on a regularly scheduled basis to review the assets.

This action plan will be completed by March 1, 2013.

2. Department asset custodians should make timely updates to assets to keep the University asset listing up to date

During the audit, we reviewed the University's asset listing for accuracy. The asset listing includes various information regarding inventorial assets:

- Purchase date and original cost;
- Location of asset;
- Asset custodian; and,
- Asset tag number.

From the review of assets and from discussions with the equipment manager and asset custodians, we noted that the information on the University's asset listing is not always updated in a timely manner. Per BUS-29, responsibilities of the departmental asset custodians include maintaining up-to-date departmental records that reconcile to the official records maintained by the Equipment Management Office. Also, asset custodians are responsible for reporting equipment utilization. If an asset will no longer be used by the campus, asset custodians should report this to the equipment manager.

For example, during the audit we reviewed campus storage and warehouse areas. At the University's Olive Ave. Warehouse, we noted assets in the custody of various departments where the location on the asset listing had not been updated to show that the assets were in storage or no longer being used.

We also noted where an asset custodian has been out for many months. The assets purchased by her department during 2012 do not include important information about the assets (serial numbers) and the locations of the assets.

It is important for an asset custodian to identify when assets are not being utilized. The equipment manager can determine whether another department can use the equipment or can sell the equipment as surplus. Also, if an asset is impaired and will no longer be used, generally accepted accounting principles (GAAP) require the asset to be written down or written off. As asset custodians have not been quick to identify when an asset will no longer be used, Accounting Services cannot identify if valuable equipment should be written off.

While BUS-29 requires at least a biennial inventory, the new equipment manager may consider utilizing more frequent cycle counting to verify that the information on the University's asset listing is up to date.

Management Action Plan:

Ideally, ensuring that Department asset custodians make timely updates to assets to keep the University asset listing up to date would be facilitated by having an asset tracking system allowing equipment custodians to access and maintain their data electronically. In lieu of an asset tracking system, custodians are expected to provide changes in equipment

status to equipment management via an EIMR (Equipment Inventory Modification Request). To ensure that information is being provided on a timely basis, Equipment Management will incorporate cycle counting to verify that the information on the University's asset listing is up to date. Cycle counts will be performed during the regular scheduled visit to verify that property tags have been affixed to the assets.

This action plan will be completed by April 1, 2013.

In order to identify assets that are not being utilized, Equipment Management will publish procedures to control university property stored in off-site locations and establish procedures to track storage items as they are moved into and out of the warehouses so assets can be utilized, equipment can be located, and the use of storage area can be optimized.

This action plan will be completed by September 1, 2013.

3. Security over computers and theft sensitive equipment should be improved

During the audit, we noted that departments have very differing levels of control over laptop computers. Some departments affix their own department asset tags to the computers and maintain lists of all computer equipment under their control, while other departments do not attempt to keep control over theft sensitive computers as the items were under the $5,000 capitalization threshold.

Most laptop computers cost less than the $5,000 capitalization threshold and are classified as "theft sensitive" items. UC Policy BFB-BUS-29: "Management and Control of University Equipment" provides the following definition and requirements related to these other inventorial items: "[Other Inventorial Items are] items purchased for less than $5,000 or that have an expected normal life of one year or less, which are not inventoried as equipment or Government property, but which are nevertheless subject to safeguards provided by the inventorial process. This category includes theft sensitive items and items specifically identified for inclusion as inventorial items by the sponsor of an extramural award. Such items are expensed (vs. capitalized), are subject to local University location inventory control procedures, and need not be reported in the EFA database."

Good IT security and UC Policy require adequate controls over laptop computers. BFB IS-3 "Electronic Information Security" requires: "Departments should establish procedures to ensure physical security for portable devices and media housed within their immediate work area and under their control, such as laptop computers, PDA's, memory sticks, CD ROM's, etc." While reporting requirements for less expensive "theft sensitive" laptops are not as stringent as more valuable "inventorial" assets, the risk related to laptop computers is the potential for the loss of confidential information on the computers rather than the cost of the equipment.

During the review of equipment maintained by departments, we noted many old laptops and other computer equipment on shelves or in storage areas. As lists are not maintained and periodically reviewed, it is uncertain whether some departments could identify if an older laptop no longer used by a current employee was missing.

We noted the same lack of control over other theft sensitive items. While departments were able to locate all of the theft sensitive items selected for testing, departments often relied upon particular employees to know that the item was located on a shelf, in a cabinet, or in storage. Most departments did not include the items on a list and then periodically verify that the items could be located. As a result, there is a risk that items could be misappropriated without another employee identifying that it is missing.

To verify that departments have procedures in place to maintain control over computers and other theft sensitive items, the equipment manager should educate department administrative employees and then periodically review that departments have necessary controls in place. The campus IT Security Officer should also periodically review that departments have controls over computers from the time of purchase until the time when they are disposed of.

Management Action Plan:

To improve security over computers and theft sensitive equipment, Equipment Management will publish local guidelines for tracking computers and theft sensitive equipment by department equipment custodians.

This action plan will be completed by April 1, 2013.

The Equipment Manager will provide information to MSO's and department equipment custodians about the system-wide policy and local guidelines regarding computers and theft sensitive equipment. This information will be provided at least once a year in an annual Equipment Management update meeting for MSOs and department equipment custodians.

This action plan will be completed by May 1, 2013.

4. Utilizing a specialized system designed for asset tracking might improve control over assets

During the audit, we noted that a spreadsheet is used to keep track of the University's capitalized assets. The original costs of assets on this spreadsheet are used as backup for the gross fixed assets on the University's financial statements.

As of July 2012, there were 1,787 assets listed on the spreadsheet. While it may have been efficient to utilize a spreadsheet when there were relatively few assets to keep track

of, as the University grows, continuing to maintain this sort of list on a spreadsheet may become cumbersome.

Control over assets could be improved with a system which enables bar coding so asset custodians might utilize their mobile devices to update the location of assets. Also, a system could allow asset custodians to upload pictures of the equipment into the system. As a spreadsheet does not easily enable this sort of functionality, some departments have begun spending time and resources programming their own systems and databases to better track the assets.

A fixed asset system could be set up so department asset custodians could enter changes to asset locations and other changes to asset information. These changes could then be reviewed and approved by department approvers and the equipment manager. Currently, when changes are made to the assets, custodians submit paper Equipment Inventory Modification Request (EIMR) forms to the equipment manager. This can be a time-consuming process for asset custodians and, as a result, they are slow in submitting asset location changes and slow in notifying the equipment manager when equipment should be sent to surplus.

Management Action Plan:

Equipment Management will research and make recommendations to management for an Equipment Management System.

This action plan will be completed by September 1, 2013.

5. Inventory controls over Facilities' spare parts should be implemented

During the audit, we noted that the Facilities department is putting together a formal storeroom for spare parts. It is estimated that value of spare parts on hand during Fall 2012 was between $200,000 and $300,000. A complete physical inventory of these spare parts has not yet been completed and the value of the inventory has not been calculated. The inventory balance is scheduled to be recorded at the end of the current fiscal year (FY 2013).

UC policy, BUS-54, "Operating Guidelines for University Supply Inventories", explains the requirements related to maintaining a storeroom. According to BUS-54, "Coordination of all supply inventories shall be a centralized responsibility on each campus assigned through the Chancellor to the Materiel Manager... The Materiel Manager, as part of his or her coordinating responsibility, may review, question, and disallow, subject to approval by the Chancellor, departmental supply inventory practices, policies and procedures." BUS-54 also outlines the following requirements related to supply inventories:

"Adequate safeguards should be provided to protect University supply inventories from pilferage or other loss. Inventories are to be verified by physical count at least annually, preferably on a cyclical basis.

Stock Adjustments are to have the signed approval of the Materiel Manager or designee who must not be the individual responsible for the inventory. Large adjustments shall be supported by an explanation."

Formal procedures for maintaining control of the spare parts inventory should be implemented and approved by the campus Materiel Manager, the Director of Purchasing. The procedures should include:

- Details related to physical inventories, such as timing and counting procedures;
- Procedures for adjusting parts balances to actual counts in the IT system; and,
- Who can access and make adjustments to spare parts inventories in the IT system

As the costs of spare parts on hand have been expensed over the years, it is estimated that prior year expenses have been overstated and income understated by between $200,000 and $300,000.

We commend Facilities employees for identifying the need to improve control over these spare parts by setting up a formal storeroom.

Management Action Plan:

The Facilities department is currently working on physical security controls and access to the new storeroom location. Written policies and procedures related to physical inventories, adjustments, and the inventory system will be completed and implemented by June 30, 2013.