

**UNIVERSITY OF CALIFORNIA, DAVIS
INTERNAL AUDIT SERVICES**

**University of California, Davis Health System
Delegated Purchasing A– Food and Nutrition Services
Internal Audit Services Project #12-08**

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MANAGEMENT SUMMARY

BACKGROUND

The UC Davis Health System (UCDHS) Department of Food and Nutrition Services (FNS) has five separate units:

- Dining Services, which supports cafeterias in the Medical Center, Ambulatory Care Center, M.I.N.D. Institute and the Medical Education Building;
- Catering Services, which caters events throughout the UCDHS upon request;
- A fifty-week dietetic internship program;
- Clinical Nutrition, the program for registered dietitians working as part of the medical team treating UCDHS patients; and
- Patient Services, the preparation and delivery of meals to UC Davis Medical Center (UCDMC) inpatients.

Total expenditures for FNS from January 2011 through December 2011 were \$16.4 million, of which \$5.6 million was spent for food and food-related items. During this timeframe, FNS recorded \$4.2 million in revenue with a budgeted equivalent of 186 full-time staff. Income from providing food for inpatients is not recorded as revenue because it is collected in the room rate and not allocated to FNS. FNS is one of two UCDHS departments with authority to make purchases outside of Eclipsys. Nine FNS staff members have unlimited delegated purchasing authority for food and food-related products.

UCDMC is a member of the University Health System Consortium (UHC), a consortium of academic medical centers. UHC members employ Novation, a supply contracting company, to negotiate contracts for food and food service products. US Foodservice (US Foods) is the contracted prime vendor for FNS. Payments to US Foods accounted for approximately 64% of the FNS total food and food-related purchases in calendar year 2011. US Foods employs a web-based system for orders. Authorized FNS staff members select items from an Order Guide, which is tailored specifically for the items and prices in the UCDMC agreement with US Foods.

Items not purchased from US Foods are ordered through Computrition, a data management system. Computrition contains all FNS recipes, the inventory of all items on hand (including US Foods purchases), the cost when the item was purchased, and the nutritional value of each item. Once the menu is set for the week, storekeepers use Computrition to determine what food items the kitchen needs and order the necessary supplies.

PURPOSE AND SCOPE

We reviewed delegated purchasing activities by FNS as part of our Fiscal Year 2012 audit plan. The purpose of the audit was to evaluate compliance with Business and Finance Bulletin BUS 43, *Materiel Management*, and to identify opportunities to improve the economy and efficiency of the operation. We reviewed FNS purchasing transactions for the period of January 2011 through December 2011. We assessed the processes FNS uses to add a new vendor and for ordering, receiving and approving purchases. We interviewed FNS personnel

and reviewed relevant policies. We also selected a sample of transactions and tested them for accuracy and compliance with policy. Finally, we examined the reports and procedures FNS management uses to monitor operations.

CONCLUSION

We conclude that the FNS delegated purchasing activities are in compliance with BUS 43. FNS monitors vendor performance and inpatient satisfaction. FNS reviews weekly reports of revenue and expenses and trends and monitors the cost of individual food items and recipes to identify less expensive alternatives.

We also identified opportunities for improving the segregation of duties and invoice processing. In addition, FNS may not be complying with University policy on recharge activities.

Our observations and recommendations are presented in the body of this report along with corresponding management corrective actions.

OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT CORRECTIVE ACTIONS

1. SEPARATION OF DUTIES

The separation of duties within the purchasing process could be strengthened.

The department manager and other members of FNS management have delegations of purchasing authority. However, they are also authorized to approve payments for the purchases. The department manager has delegated purchasing authority by virtue of his position and the food service managers have delegations of purchasing authority to allow them to place orders in an emergency when no other purchasers are available.

UCDHS Hospital Policies and Procedures 1816, *Departmental Financial Administrative Controls and Separation of Duties*, requires departmental financial administrative duties to be separated so that one person's work routinely serves as a complementary check on another's work, and no one person has complete control of a financial transaction. For non-payroll disbursements, the person who requisitions the purchase transaction should be someone other than the person who approves the transaction, and the person approving purchase transactions should be someone other than the person performing the required monthly review of the DaFIS Transaction Listing.

Failure to properly separate these duties increases the risk of misappropriated funds through fraudulent transactions. Separation of the abilities to initiate and approve transactions is a fundamental control necessary to deter, detect and prevent fraud. The proper separation of duties also increases the likelihood of detecting errors and serves to protect innocent employees from suspicion in the event of a loss.

Recommendations

FNS should revoke the delegated purchasing authority of any FNS staff responsible for approving invoices for payment.

Management Corrective Actions

FNS management will implement the following process: Any Department Manager who has the designated authority to approve invoice payments, when needed to purchase, will obtain a counter signature of any purchases they may submit. The counter signature will be from another manager from UCDHS Food and Nutrition Services that has designated invoice approval authority.

Implementation Date: July 31, 2012

2. PURCHASING AND PAYMENT PROCEDURES

Purchasing and payment procedures could be improved for smaller vendors.

FNS receives several small invoices each week from some vendors. Food vendors can deliver as often as daily, and some vendors submit an invoice for every delivery. Invoices for less than \$50.00 make up less than 1% of total expenditures, yet comprise nearly 29% of all invoices processed. FNS reviews all purchase orders generated for these vendors before the order is placed and processes each resulting invoice separately. FNS concluded that pre-approving each purchase and processing each invoice individually were required internal control procedures.

The following chart reflects the invoices processed by number and amount:

Range of Invoice Totals	Expense for All Invoices in Range	% of Total Expenses	No. of Invoices in Range	% of Invoices
0.00-49.99	\$ 43,672	0.77%	2085	28.86%
50.00-99.99	\$ 63,556	1.12%	897	12.42%
100.00-149.99	\$ 91,954	1.62%	744	10.30%
150.00-199.99	\$ 133,668	2.36%	765	10.59%
200.00-249.99	\$ 103,709	1.83%	473	6.55%
250.00-299.99	\$ 74,794	1.32%	271	3.75%
300.00-349.99	\$ 60,938	1.08%	188	2.60%
350.00-399.99	\$ 52,652	0.93%	141	1.95%
400.00-449.99	\$ 50,911	0.90%	120	1.66%
450.00-499.99	\$ 58,145	1.03%	123	1.70%
500.00-999.99	\$ 372,362	6.58%	537	7.43%
1000.00-1999.99	\$ 451,615	7.98%	304	4.21%
2000.00-2999.99	\$ 512,002	9.05%	210	2.91%
3000.00-3999.99	\$ 276,340	4.88%	78	1.08%
4000.00-4999.99	\$ 70,755	1.25%	16	0.22%
5000.00-7499.99	\$ 173,056	3.06%	28	0.39%
7500.00-9999.99	\$ 385,568	6.81%	42	0.58%
10000.00-12499.99	\$ 1,037,221	18.33%	93	1.29%
12500.00-14999.99	\$ 910,438	16.09%	66	0.91%
15000.00-17499.99	\$ 562,852	9.94%	35	0.48%
17500.00-19999.99	\$ 128,830	2.28%	7	0.10%
20000.00+	\$ 44,763	0.79%	2	0.03%
Grand Total	\$ 5,659,801	100.00%	7225	100.00%

Regents Policy 5100, *Resolution Regarding Administrative Efficiencies*, details the Regents' commitment to efficiencies in administration as a method to achieve a sustainable financial model. FNS reviews orders from US Foods after they are placed and the additional procedures FNS established for processing other purchasing transactions, including transactions totaling less than \$10.00, appears inefficient relative to the risks involved.

Recommendations

FNS should consider granting storekeepers authority to make purchases under an established threshold without prior review and requesting monthly invoices from vendors, or processing multiple invoices from the same vendor on a monthly basis.

Management Corrective Actions

FNS will grant storekeepers authority to make purchases under \$5,001.00 without prior review and the FNS Purchasing Manager will begin reviewing these purchases after they are compiled in a Daily Invoice Summary by July 31, 2012.

FNS will ask vendors to submit monthly invoices and/or process multiple invoices from the same vendor on a monthly basis beginning October 1, 2012.

3. INTERNAL CONTROLS

Compliance with established internal controls could be improved.

FNS strengthened several internal control procedures in response to a September 2011 review by the Purchasing Department. These procedures require signatures evidencing receipt and/or transfer of the items purchased and approval for payment on the related invoice. However, numerous invoices we tested were missing one or more signatures required to demonstrate compliance with the internal control procedures established to ensure the proper separation of duties. The rate of exceptions decreased from 30% in 2011 to 14.3% in 2012.

Conditions at the loading dock and FNS storeroom are often chaotic. Multiple interruptions and distractions reportedly resulted in FNS staff forgetting to provide the required signatures.

PPM 350-21, *Departmental Purchase Delegations*, requires purchasing, receiving, and financial report reviewing duties to be separated so that one person's work routinely serves as a complementary check on another's work, and no one person has complete control of a purchase transaction. Failure to ensure compliance with established internal control procedures increases the risk of theft or fraudulent payments.

Recommendations

FNS should implement a process to ensure compliance with established internal control procedures.

Management Corrective Actions

FNS will implement a process for monitoring compliance with established internal control procedures by September 30, 2012.

4. CATERING ACTIVITIES

Accounting for catering activities could be improved.

FNS calculates the cost of each item on the catering menu based on the cost of the food alone. The labor cost to prepare and serve the food is not included. FNS adds a markup based on a reasonable price for the item. Their goal is to average a food cost that is 50% of the price. However, FNS does not match the revenues and expenses for the catering activities to determine if the amount charged is sufficient to break even on the activity.

The design of FNS financial accounts does not facilitate tracking the performance of a particular function. For example, catering income is assigned to one account while food costs are charged to a separate account. Moreover, to assist with benchmarking reviews, FNS does not separately account for food and labor costs specifically for catering activities. FNS considers catering a service provided to support the Health System and its mission, as opposed to a recharge activity, and considers the cost of labor for catered events part of that service. In addition, FNS strives to remain competitive with other approved vendors for catering at the Health System.

UC Davis policy PPM 340-25, *Recharge Activities*, states that recharge activities must be managed so as to recover the full direct cost of providing the goods or services and operate on a break-even basis. This policy defines a recharge activity as an activity that provides specific, ongoing, repetitive goods or services to campus units on a fee basis. The UCD Administrative Responsibilities Handbook states that units of the university must follow generally accepted accounting principles (GAAP) and provide reports that present a complete picture of the university's funds and their uses. GAAP requires sources and uses of funds to be grouped by the type of activity they support.

Because FNS does not match revenues and expenses for catering activities and excludes the labor cost from the calculations of its recharge rates, FNS cannot accurately calculate a markup that will cover the true cost of the services and/or provide accurate financial reports to management on the results of the catering activity. As a result, the UCDCM may be inadvertently subsidizing the activities of other entities such as the School of Medicine and School of Nursing.

Recommendations

FNS should perform an analysis to determine the actual cost of the catering activities and the mark-up necessary to recover the full cost of the services provided for management review in determining whether to comply with University policy governing recharge activities, or seek an exemption from the policy.

Management Corrective Actions

FNS will perform an analysis of the catering activities and present the results to UCDHS management for a decision regarding compliance with or exemption from University policy governing recharge activities by November 30, 2012.
