



UCSB Audit and Advisory Services

Internal Audit Report

**University Inventories
Phase I Interim Report**

February 7, 2014

Performed by:

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Approved by:

Robert Tarsia, Director

Report No. 08-14-0002

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AUDIT AND ADVISORY SERVICES
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February 7, 2014

To: Jim Corkill, Controller and Director
Business and Financial Services

Re: **University Inventories - Phase I Interim Report**
Audit Report No. 08-14-0002

As part of the 2013-14 annual audit services plan, Audit and Advisory Services has completed Phase I of our audit of University Inventories. Enclosed is the audit report detailing the results of our review.

The primary purpose of this audit is to ensure that University of California, Santa Barbara campus inventories (and non-inventoried stock) such as supplies and equipment are properly controlled and safeguarded from loss, and to assess whether processes and procedures implemented by campus departments are in compliance with University and sponsor regulations and policies.

One of the objectives of this project is a campus-wide inventory risk assessment to identify the types, locations, and value of campus inventories (and non-inventoried stock). Following that phase of the work, we are performing the detailed audit fieldwork in two phases, with the goal of covering approximately four to five areas of focus in each phase. The audit objectives for each area of focus include an assessment of the effectiveness of processes, policies and procedures, and controls in place for receiving, issuing, safeguarding, and accounting for inventories of various types.

Our completed Phase I work includes the campus-wide inventory risk assessment and detailed audit fieldwork in the following departments or units:

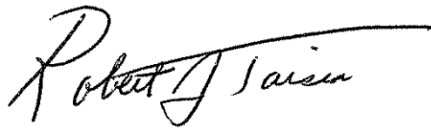
- Facilities Maintenance
- Central Stores
- Police Department
- Department of Music

The results of our work identified opportunities for improvement in department practices. In particular, improvements are needed in practices for safeguarding and accounting for items below dollar thresholds that would require tracking the items as property, or accounting for the items as inventoried supplies. Most of these items are considered theft-sensitive.

Our work also identified areas for potential improvements in central department and campus-wide processes. In consultation with Business and Financial Services, we are deferring recommendations in these areas until completion of Phase 2 of this audit. We believe that we will then have a fuller understanding of the potential exposure to the campus, which would assist Business and Financial Services in making prudent, cost-effective decisions in these areas.

Detailed observations and management corrective actions are included in the following sections of the report. The management corrective actions provided indicate that each audit observation was given thoughtful consideration and that positive measures have been taken or planned to implement the management corrective actions. The cooperation and assistance provided during the review by personnel in Business and Financial Services, Facilities Maintenance, the Police Department, and the Department of Music was greatly appreciated. If you have any questions, please feel free to contact me.

Respectfully submitted,

A handwritten signature in black ink that reads "Robert Tarsia". The signature is written in a cursive style with a long horizontal line extending from the end of the name.

Robert Tarsia
Director
Audit and Advisory Services

Enclosure

cc: Chancellor Henry Yang
Senior Associate Vice Chancellor Marc Fisher
UCSB Audit Committee
Senior Vice President and Chief Compliance and Audit Officer Sheryl Vacca

Administrative Services

Acting Associate Vice Chancellor Pam Lombardo
Chief Dustin Olson, UC Police Department
Jackie Treadway, Director, Facilities Maintenance
Leslie Griffin, Associate Director, Business & Financial Services
Jacob Godfrey, Associate Director and Materiel Manager, Business & Financial Services
Vaughn Boyle, Equipment Manager, Business & Financial Services

Department of Music

Jill Felber, Chair
Cori Montgomery, Management Services Officer

PURPOSE

The primary purpose of this audit is to ensure that University of California, Santa Barbara (UCSB) campus inventories (and non-inventoried stock) such as supplies and equipment are properly controlled and safeguarded from loss, and to assess whether processes and procedures implemented by campus departments are in compliance with University and sponsor regulations and policies. This audit, which is being performed in two phases, is part of UCSB's 2013-14 annual audit services plan.

SCOPE, OBJECTIVES AND METHODOLOGY

The scope of this project includes campus inventories of equipment, supplies, materials, and substances, regardless of whether the amounts involved meet applicable dollar thresholds that would require tracking the items as property or accounting for the items as inventorial supplies.

We narrowed the scope of our detailed fieldwork based on risk. One of the objectives of this project was a campus-wide inventory risk assessment to identify the types, locations, and value of campus inventories (and non-inventoried stock). After completing that phase of the work, we are performing the detailed audit fieldwork in two phases, with the goal of covering approximately four to five areas of focus in each phase. The audit objectives for each area of focus include an assessment of the effectiveness of processes, policies and procedures, and controls in place for receiving, issuing, safeguarding, and accounting for inventories of various types.

Data Gathering and Risk Assessment

We performed extensive background and data gathering work to inform the risk assessment phase of this project, including:

- An assessment of policies and procedures that included:
 - Reviewing and evaluating federal regulations and University of California (UC) and UCSB policies and procedures relevant to the audit, including those that address what goods must be accounted for as inventory; what goods should be tracked even if below the inventory threshold; special requirements for different categories and types of equipment, supplies, and other inventory; and other potentially relevant areas.
 - Identifying UCSB *departmental* policies and procedures that are possible campus best practices.
 - Internet research to identify common policies and procedures other institutions have in the functional areas in the scope of the audit.
- Review of other audits and reviews relevant to this audit, including work by UCSB Audit and Advisory Services (including department audits and investigations that included some coverage of relevant areas); other UC campuses, and other universities and institutions.
- Interviews, brainstorming sessions, and a survey of Academic Business Officer Group (ABOG) members to solicit concerns and more fully develop the risk areas that should be considered for coverage.

UCSB Audit and Advisory Services
University Inventories - Phase I Interim Report

- Walkthroughs of select campus inventory locations to gain an understanding of campus purchasing, receiving, stocking, distribution, and safeguarding processes.

Based on our background and data gathering work, we prepared an extensive preliminary list of inventory risk areas that included:

- Campus-wide or central inventories of specific equipment, supplies, materials, substances, etc.
- Specific departments.
- Specific storerooms and storage locations.
- Other auditable inventory areas.

To complete an effective risk assessment, we found it useful to categorize campus inventories to take into consideration:

- *Inventorial vs. Non-Inventorial Equipment* – As discussed later in the Background section of this report, University policies establish inventory and other requirements for property defined as University Inventorial Equipment, Government Inventorial Equipment, Other Government Property¹, and Other Inventorial Items. The applicability of the specified requirements for the different categories of inventory, and the risks of non-compliance with these requirements, was considered particularly relevant in our assessment of risk.
- *Inventorial vs. Non-Inventorial Supplies* – University policies also establish a general threshold for supply inventories that specifies that supplies inventories exist when the combined inventory value of new and unissued material in a department exceeds \$50,000 at one or more locations on a campus, or exceeds \$50,000 at an off-site campus location.
- *Special/High Compliance Inventories* - Inventory requiring special handling and/or that are subject to rigorous compliance requirements, such as firearms, controlled substances, precious metals, cadavers, and vehicles. We used this “catch-all” category for risk assessment and audit planning purposes to identify higher-risk inventories, departments, programs, or other auditable areas, regardless of dollar value.

Other factors considered in completing the risk assessment included:

- Inventory levels and dollar value.
- Equipment, supplies, materials, substances, etc. considered at higher risk for loss or theft.
- Highly specialized inventory.
- Inventory types and/or organizational units for which there has been little or no prior campus audit coverage.

Some of the risk areas we identified or documented, such as controlled substances, were excluded from the potential scope of our detailed fieldwork because, in our judgment, they should be considered for separate, future audit coverage due to the specialized nature of applicable compliance requirements.

¹ *Government Inventorial Equipment* is defined as equipment to which the Government holds title but which is held in custody by the University, which is non-expendable, tangible, personal property acquired for \$5,000 or more, which is freestanding, complete in itself, does not lose its identity or become a component part of another piece of equipment when put into use, and which has a normal life expectancy of more than one year. *Government Property* is defined as all property owned or leased by the Government; it includes both Government-furnished and Contractor-acquired property.

Phase 1 Areas of Focus

As a result of our campus-wide assessment, we selected the following departments for detailed audit work for Phase I of this project:

- Facilities Maintenance
- Central Stores
- Police Department
- Department of Music

Our work in these departments included:

- Gaining a fuller understanding of the types of inventories the department is responsible for (e.g. inventorial vs. non-inventorial equipment and supplies, government inventorial equipment, special/high compliance inventories, etc.), and their volume and value.
- Gaining and documenting an understanding of departmental inventory processes, policies and procedures, and use of systems such as the Capital Assets Tracking System (CATS) and Grand Unified System (GUS), a widely used campus shadow system.²
- Performing walkthroughs with knowledgeable personnel of departmental processes for receiving, issuing, safeguarding, and accounting for inventories of various types.
- Detailed testing, as considered necessary, to determine whether departmental processes are in place and operating as intended, including sample inventory accounts and testing of purchase, receiving, issuing, disposal, and adjustment transactions.

Table 1 lists the specific types of inventories we selected for review, based on our judgment of risk and the available audit resources.

This audit was conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*.

² A shadow system is any application or database used for business processes that is not provided and supported centrally.

Table 1		University Inventories Audit – Phase 1 Areas of Focus	
Department		Inventory Reviewed	
Facilities Maintenance		Equipment, tools, parts, materials, and supplies	
Central Stores		Surplus/disposed equipment from other departments	
Police Department		Firearms stored in armory, evidence room, bicycles	
Department of Music		Pianos, other musical instruments, and production equipment	

Source: Auditor Analysis

BACKGROUND

Campus operations include a wide variety of inventorial and non-inventorial equipment, supplies, materials, substances and other items located at, and utilized by, a wide range of facilities, including offices, labs, garages, machine shops, and other facilities. The scope and decentralization of UCSB’s operations increase the likelihood that University resources will be used for non-UC business, otherwise misused, or stolen. We included this project in UCSB’s 2013-14 annual audit services plan due to these factors.

Regulations and Policies

Table 2 outlines the principal regulations, policies, and procedures we considered most relevant to the scope of this audit. These include:

- OMB Circular A-110, *Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations*, sets forth uniform standards governing management and disposition of property furnished by the Federal Government whose cost was charged to a project supported by a Federal award. Among other requirements, A-110 requires physical inventory of equipment at least once every two years, and requires the institution to maintain a control system to ensure adequate safeguards to prevent loss, damage, or theft.
- OMB Circular A-21, *Cost Principles for Educational Institutions*, establishes principles for determining costs applicable to grants, contracts, and other agreements with educational institutions. A-21 includes various provisions relevant to the scope of this audit, especially provisions related to equipment and supplies. Among other requirements, A-21 specifies that purchased materials and supplies are to be charged at their actual prices, and that withdrawals from general stores or stockrooms should be charged at their actual net cost. Only materials and supplies actually used for the performance of a sponsored agreement may be charged as direct costs.

- BFB BUS-29, *Management and Control of University Equipment*, establishes inventory and other requirements for property defined as University Inventorial Equipment, Government Inventorial Equipment, Other Government Property, and Other Inventorial Items. Although there is a general cost threshold of \$5,000 for equipment to be inventorial, the actual requirements depend on the property category and specific requirements to which the property is subject. For example, the Other Inventorial Items category includes firearms as well as items acquired under extramural awards that set a dollar limit of less than \$5,000 for inventorial items. BFB BUS-29 also specifies that each University location may establish more restrictive local policies and procedures, for example, for Other Inventorial Items or other items that are theft sensitive.
- BFB-BUS-54, *Operating Guidelines for University Supply Inventories*, establishes a general threshold for supply inventories that specifies that supplies inventories exist when the combined inventory value of new and unissued material in a department exceeds \$50,000 at one or more locations on a campus, or exceeds \$50,000 at an off-site campus location.
- BFB-BUS-38, *Disposition of Excess Property and Transfer of University Owned Property*, addresses the disposition of all University-owned personal property (vs. real property) that has been determined to have no continuing value to the University. It includes requirements to ensure the proper protection of, accounting for, and disposition of University-owned excess property, including specifying acceptable methods of disposition and restrictions on the disposition and use of property. BFB BUS-38 also specifies that each University location may establish more restrictive local policies and procedures

Phase 1 Departments

Facilities Maintenance – Facilities Maintenance is one of the divisions under the umbrella of Campus Design & Facilities, which is part of the Vice Chancellor, Administrative Services organization. It provides a wide range of services to the campus, including landscaping and grounds maintenance, pest management, energy and utility (including electrical and plumbing), and custodial services. Facilities Maintenance also includes a Financial Services unit that supports the entire Campus Design & Facilities organization, including Design and Construction. Facilities Maintenance resources considered relevant to the scope of this review include a wide range of equipment, tools, parts, materials, and supplies.

Central Stores – Central Stores is a unit of Business and Financial Services, which is part of the Vice Chancellor, Administrative Services organization. Central Stores accepts surplus property for disposal or sale, and handle sales of that property. The department accepts office furniture, computer equipment and electronics, e-waste, and lab equipment, as well as vehicles. According to Central Stores personnel, the majority of the accepted items are valued under the \$5000 threshold for inventory recording purposes. Central Stores accepts items in both working and non-working condition.

Police Department – The UCSB Police Department is a full service police organization charged with providing for the peace, safety, and security of persons and facilities on the University campus, and of properties owned, controlled, or occupied by the University of California. Resources considered relevant to the scope of this review include firearms stored in the Police Department's armory and the contents of the department's evidence room.

Although not University-owned property, we also considered the department's stock of used bicycles relevant to the scope of this audit. These bicycles come into the Police Department's

UCSB Audit and Advisory Services
University Inventories - Phase I Interim Report

possession when they are impounded due to being illegally parked, stolen, or abandoned, many at the end of each school year. The Community Service Organization, which is comprised of UCSB students who work collaboratively with the Police Department in a number of areas, assists in maintaining the inventory of unclaimed bicycles and in their disposition, most through online police auction.

Department of Music - The Department of Music offers undergraduate and graduate programs for Music students. The department provides opportunities for student to participate in various groups and ensembles, and offers a regular series of concerts and events. Inventory items include pianos, other musical instruments, production equipment, and a musical scores collection.

Table 2 Principal Regulations, Policies, and Procedures Applicable to Inventories	
Federal	
OMB Circular A-110 <i>2 CFR, Part 215</i>	Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations
OMB Circular A-21, <i>2 CFR, Part 220</i>	Cost Principles for Educational Institutions
OMB Circular A-133	Audits of States, Local Governments and Non-Profit Organizations
University of California	
BFB BUS-29	Management and Control of University Equipment
BFB-BUS-38	Disposition of Excess Property and Transfer of University Owned Property
BFB BUS-43	Materiel Management
BFB BUS-54	Operating Guidelines for University Supply Inventory
UCSB	
Purchasing/Equipment Management <i>Procedure Issued October 2003</i>	Reporting the Loss or Theft of Inventorial Equipment
Purchasing/Equipment Management <i>Website Content</i>	Physical Inventories
Accounting Manual <i>P-415-2</i>	Plant Accounting: Costing and Reconciling Inventorial Equipment Acquisitions

Source: Auditor Analysis

SUMMARY OPINION

We identified opportunities for improvement in department practices, in particular practices for safeguarding and accounting for items below the applicable dollar thresholds that would require tracking the items as property, or accounting for the items as inventorial supplies. Most of these items are considered theft-sensitive.

Our work also identified areas for potential improvements in central department and campus-wide processes. In consultation with Business and Financial Services, we are deferring recommendations in these areas until completion of Phase 2 of this audit. We believe that we will then have a fuller understanding of the potential exposure to the campus, which would assist Business and Financial Services in making prudent, cost-effective decisions in these areas.

DETAILED OBSERVATIONS AND MANAGEMENT CORRECTIVE ACTIONS

A. Issues and Recommendations Under Consideration for Final Report

We have identified two areas for potential improvements in central department and campus-wide processes. In consultation with Business and Financial Services, we are deferring recommendations in these areas until completion of Phase 2 of this audit, as discussed above.

1. Theft-sensitive Equipment Under \$5,000

The results of Phase I of this audit, as well as the results of prior audits and investigations by Audit and Advisory Services, suggest a need to establish and communicate better campus guidance for controlling and safeguarding equipment and other property that is not inventorial under existing policies. As outlined in the Background section of this report, BFB BUS-29, *Management and Control of University Equipment*, establishes a general cost threshold of \$5,000 for equipment to be inventorial, along with some additional requirements that depend on the property and the specific requirements to which the property is subject. BFB BUS-29 also specifies that each University location may establish more restrictive local policies and procedures.

Based on our work on this and prior projects, we believe it would be prudent for Business and Financial Services to establish more restrictive local policies and procedures, or at least provide additional campus-wide guidance, for certain types of property that cost less than the general cost threshold of \$5,000 for equipment to be inventorial – in particular, theft sensitive items such as computers and tools.

2. Tracking and Disposal of Equipment Under \$5,000

As discussed in the Background section of this report, Central Stores accepts for disposal or sale excess furniture, computer equipment and electronics, and other property, with the majority of the items valued under the \$5,000 threshold for inventory recording purposes. We noted that there are no campus-wide requirements in most cases for documenting the release to Central Stores of property under the \$5,000 threshold, through to disposing of these items. Although current practices are consistent with existing policies, it is our opinion that the practices lessen accountability for this property and further increase the likelihood of theft, especially for theft sensitive items such as

computers and tools. Based on our work on this and prior projects, we believe it would be prudent for Business and Financial Services to establish more rigorous practices in this area.

We will address these issues in more detail in our final report on this project, to be issued after the completion of Phase 2.

B. Continue Improvement Efforts in Facilities Maintenance

Facilities Maintenance is aware of a number of weaknesses in its current systems and practices and has started a re-engineering process to address them. Weaknesses have been identified in the following areas:

- Physical safeguard of some assets.
- Written departmental policies and procedures that sufficiently define processes, roles and responsibilities.
- Lack of a system that adequately tracks supplies inventories and provides management information and reporting on inventory use, turnover, etc.
- Other internal control issues, including insufficient tracking of theft-sensitive equipment under the \$5,000 inventorial threshold, insufficient segregation of duties between custodian and record-keeping functions, and inadequate employee accountability for tools and equipment in their custody.

It is our understanding that the department needs to consider its limited resources as it works on the re-engineering process, and that it needs to consider costs and benefits. Based on our work on this and other projects, we believe that implementing improved systems and practices would be prudent.

Management Corrective Actions

Facilities Maintenance will continue its re-engineering process and intends to make additional, measurable progress by:

- April 30, 2014, by addressing immediate issues regarding safeguarding of assets.
- July 31, 2014, to complete written policies and procedures, including defining and documenting appropriate roles and responsibilities.
- January 31, 2015, to complete all our work in this area, including the planned implementation of a new system.

Audit and Advisory Services will follow up on the safeguarding of assets and written policies and procedures by August 31, 2014. We will also include the department's overall reengineering process in the scope of a field audit follow-up being planned for the quarter ending March 31, 2015.

C. Recommended Improvements for the Police Department

Our work involving the Police Department's stock of used bicycles did not identify any areas of concern. We do have modest recommendations for improvements involving the department's firearms and evidence room.

1. Armory

Our physical inventory of the department's armory identified needed updates to central campus records maintained in the Capital Assets Tracking System (CATS). A 2012 bulk firearms purchase involving trade-in of old equipment had not been properly entered in CATS, a matter that was immediately corrected by the Equipment Management unit of Business and Financial Services. We also identified some additional firearms in the department's custody (e.g. equipment borrowed or awarded by courts) that were not reflected in CATS due to processing errors.

The Police Department should work with Equipment Management to ensure that CATS is properly updated. Going forward, the department should ensure that there is a complete physical inventory of the armory each year, including reconciliation of department records to CATS.

2. Evidence Room

The Police Department uses a FileMaker Pro database to track items maintained in its evidence room. We compared a sample of items in the evidence room to current data in FileMaker Pro, and identified one discrepancy. Although the discrepancy was promptly corrected, we learned that the Police Department relies on periodic spot checks to ensure that all evidence room items are accounted for, but does not perform complete physical inventories and reconciliation to the FileMaker Pro database. We were advised that the department is implementing a new barcode system for tracking evidence room inventory, and that inventory records transferred to the new system will then be completely accurate. This would facilitate complete physical inventories and reconciliation to the new database.

The Police Department should complete implementation of the new system, and then start performing complete physical inventories on a periodic basis.

Management Corrective Actions

The Police Department will:

- Work with Equipment Management to ensure 100% accuracy of CATS firearms records. Going forward, the department will ensure that there is a complete physical inventory of the armory each year, including reconciliation of department records to CATS.
- Complete implementation of the new system by December 12th, 2014, and then start performing complete physical inventories on a periodic basis, including annually.

Audit and Advisory Services will follow up on the status of these issues by September 30, 2014, for the armory, and January 31, 2015, for the evidence room.

D. Better Accountability for Department of Music Property

We learned during our fieldwork that the Department of Music had not been maintaining a comprehensive property or inventory listing, but had started the process of compiling such a listing and plans to perform complete annual physical counts going forward.

At the time of our work, the department's inventory listing did not include all musical instruments, such as percussion and ethnomusicology instruments, and certain theater equipment was not being sufficiently tracked. These items of equipment fall below the \$5,000 inventorial threshold; however, we found that they should be better tracked and inventoried because of their sensitivity to theft.

We recommend that the Department of Music:

- Develop written departmental policies and procedures covering the tracking and physical inventory of its equipment, musical instruments, and other property. These procedures should take into account the specialized and theft-sensitive nature of these items, and should cover the maintenance of the property/inventory listing, the physical inventory process, and the frequency of physical counts.
- Update its current department property/inventory listing to include, at a minimum, all theft-sensitive items under \$5,000, in addition to items over \$5,000 required to be inventoried under UC policies.
- Perform a complete physical count on at least an annual basis.

Management Corrective Actions

The Department of Music will:

- Develop written departmental policies and procedures covering the tracking and physical inventory of musical instruments and other property, regardless of value. These procedures will cover the maintenance of the property/inventory listing, the physical inventory process, and the frequency of physical counts.
- Update our department property/inventory listing to include, at a minimum, all theft-sensitive items under \$5,000, in addition to items over \$5,000 required to be inventoried under UC policies.
- Perform a complete physical count on at least an annual basis.

The Department of Music has committed to completing this work by April 30, 2014; Audit and Advisory Services will follow up on the status of this issue by May 31, 2014.