

August 20, 2012

FAYE E. MC CULLOUGH
Director, Disbursements and Travel
0955

***Subject: Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06***

The final audit report for the above referenced audit is attached. We would like to thank all members of the department for their cooperation and assistance during the audit.

Because we were able to reach agreement regarding corrective actions to be taken in response to the audit recommendations, a formal response to the report is not requested.

The management corrective actions included in this report will be added to our follow-up system. We will contact you at the appropriate time to schedule a follow-up review.

UC wide policy requires that all draft audit reports, both printed (copied on tan paper for ease of identification) and electronic, be destroyed after the final report is issued. Because draft reports can contain sensitive information, please either return these documents to mail code 0919 or destroy them at this time.

Terri Buchanan
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Attachment

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AUDIT & MANAGEMENT ADVISORY SERVICES



University of California
San Diego

**Payment Authorizations – Payments to Employees
June 2012**

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Project Number: 2012-06

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

Table of Contents

I.	Background.....	1
II.	Audit Objective, Scope, and Procedures.....	2
III.	Conclusion	2
IV.	Observations and Management Corrective Actions	3
	A. Non-compliance with Procurement Controls.....	3
	B. Student Organization Fund Approval Processes.....	8

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

I. Background

Audit & Management Advisory Services (AMAS) completed a review of payments to employees via Payment Authorizations as part of the approved audit plan for Fiscal Year 2011-12. This report summarizes the results of our review.

The Payment Authorization module in the University of California, San Diego (UCSD) Integrated Financial Information System (IFIS) is used to make reimbursements and direct payments to persons and entities for University goods and services that would not be typically handled by a purchase order, billing, procurement card (Express Card), or travel voucher. Under certain circumstances, it might be necessary for a person to make authorized purchases or incur official business expenses using their personal funds. Payment Authorization can be used to issue reimbursements as long as applicable policy is followed. Examples of payments to employees (many of which are reimbursements) include the following:

- Books;
- Entertainment;
- Memberships;
- Mileage for the use of a personal automobile;
- Subscriptions;
- Business-related charges incurred on a personal home telephone; and
- Miscellaneous supplies, or items needed on an emergency basis.

While Disbursements has oversight responsibility to ensure accurate payments via Payment Authorizations, primary responsibility resides with the Department preparer for:

- Compliance with applicable policies;
- Accuracy of information provided in support of payment;
- Appropriateness of the funding source; and
- Identification of payments as income to the recipient for tax reporting purposes.

Payment Authorizations are prepared and approved by campus departments, and are submitted to Disbursements. If the request requires supporting documentation, Disbursements approval is held until the required hardcopy documentation is received. Once the required supporting documentation is received, the documentation is generally scanned into the IDOCS imaging system. At this point, the Payment Authorization is reviewed, follow up may be performed with the preparer and/or University procurement specialists, and the Payment Authorization is approved or denied. If the Payment Authorization is approved, the expense is paid through Disbursements.

At the time of our audit, the University was developing a new online system (MyPayments) for processing payments to be released in 2013. The MyPayments system

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

and associated processes will include many new features that should assist with policy and procedural issues associated with compliance and document creation.

II. Audit Objective, Scope, and Procedures

The objective of our review was to evaluate the adequacy of central administrative oversight and internal controls for payments to employees via the Payment Authorization module in IFIS.

The scope of the audit included payments to employees in the Fiscal Year ended June 30, 2011 and the first quarter of the Fiscal Year 2011-12. Within IFIS, any document number beginning with the letter “P” indicates this is a Payment Authorization. Since the scope of this audit included only payments to employees, AMAS tested and then relied on the Vendor Code Type field of “Employee Number” in IFIS to identify the population of transactions for detailed testing. Using these criteria, AMAS identified 33,269 payment documents in the 15 month period.

In order to achieve our objectives we completed the following:

- Reviewed University of California (UC) and UCSD policies and procedures related to Payment Authorizations, payments to employees and associated transactions;
- Interviewed Disbursements staff to gain an understanding of current procedures, of the MyPayments system and controls being developed, and of the status of Payment Authorization analytics;
- Selected a random sample of 20 transactions with a vendor code, and confirmed that the vendor type code field could be used to identify payments to employees;
- Selected a judgmental sample of 58 employee Payment Authorization transactions, and evaluated the effectiveness of the process;
- Selected a judgmental sample of 20 employee Payment Authorization transactions, and tested for compliance with UC sales and use tax requirements;
- Selected a judgmental sample of 20 computer purchases via Payment Authorizations, and evaluated the reasonableness of the purpose; and
- Selected and analyzed the procurement method for a random selection of 200 employee reimbursement Payment Authorizations.

III. Conclusion

Based on our audit procedures, we concluded that in general internal controls over the processing of payments to employees via Payment Authorizations appeared adequate to ensure the accuracy of resulting payments. Disbursements generally provided education

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

to preparers regarding process improvements to ensure compliance with University policies and procedures. However, we noted opportunities for improvement in selected processes and controls; to provide additional education to preparers; and to improve compliance and accuracy of payments. These are described in more detail in the remainder of this report.

IV. Observations and Management Corrective Actions

A. Non-compliance with Procurement Controls

We noted a number of reimbursement transactions in which the use of Payment Authorization to acquire goods and services resulted in the non-compliance with procurement controls, as noted below.

Based strictly on the number of transactions that were not compliant with policy, it appears that some of the transactions may have been purchases made directly by employees, in conjunction with subsequent reimbursements processed via Payment Authorization, as a means to circumvent purchasing controls.

Procurement Methods - University policies and procedures associated with procurement methods are in part established to provide oversight and to ensure compliance with requirements derived from the Internal Revenue Service (IRS), Immigration and Naturalization Service (INS), funding agencies, and internal regulations. The *University of California (UC) Accounting Manual Policy D-371-16, Disbursements: Approvals Required* states that reimbursements to University employees for purchases of goods should be discouraged as there are other options available for making such purchases.

In our analysis of randomly selected payments to employees, we noted that 101 of 200 (51%) appeared to be for goods which ideally would have been acquired by more traditional procurement methods, such as:

- Express Card,
- Marketplace,
- Purchase Order, or
- Bookstore Recharge.

We observed that documentation often included inquiries from Disbursements regarding the reason that a more appropriate procurement method was not used. In general, Disbursements used that dialogue with originating departments to provide education regarding University policies and procedures.

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

Purchasing methods have been developed to support appropriate review for specific types of transactions to ensure that transactions meet applicable requirements. For example, the purchase order process ensures the inclusion of purchase order terms and conditions. Services paid to individuals should be made through purchase orders to ensure an evaluation of independent contractor criteria has been performed, to ensure proper documents are obtained, and to ensure proper withholding for income tax. During our review of transactions, we identified seven transactions containing reimbursements for services that should have been subject to independent contractor consideration prior to the purchase decisions.

The volume of employee reimbursements for goods and services which should have been purchased by other means suggests that continued training and additional communication to the campus may be appropriate to discourage the practice of bypassing procurement controls.

Delegation of Authority - According to the UCSD Blink guidance for department buyer roles and responsibilities, department buyers have been delegated authority to purchase materials, supplies, services, and repairs when these goods and services:

- Do not exceed \$2,500, including tax, freight, and handling charges (Express Order and Express Card allows for transactions up to \$4,999);
- Do not qualify as equipment, including non-inventorial equipment;
- Are not restricted items; and
- Do not require a signed contract.

Most UCSD procurement methods have training requirements for the buyer to ensure proper processing and controls are achieved. However, employee reimbursements via Payment Authorization can be requested by any employee (although department template hierarchies must be established to process a Payment Authorization). Preparation and approval of the Payment Authorization is conducted subsequent to the purchase, and independent of purchasing approval authorities. Remediation options are limited because the transaction has already occurred.

In our judgmental sample 58 Payment Authorizations, 13 (22%) exceeded the \$2,500, and six (10%) exceeded \$4,999. Payments to employees via Payment Authorization exceeded the delegation of authority thresholds for these transactions.

*Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06*

Non-Inventorial Computer Equipment - Non-inventorial equipment is defined as having a cost between \$1,500 and \$4,999 and requires tracking through the financial system, or the elective module in the Campus Asset Management System (CAMS).

UCSD Payment Authorization training states that Payment Authorizations should not be used for the purchase of personal computers. During our analytical review of randomly selected Payment Authorizations, we noted that six of 200 (3%) were purchases of computers.

Procurement of electronic communication devices, and reimbursement via Payment Authorization:

- Bypasses the University's technology procurement systems and standards, which are designed to ensure the quality of hardware and software acquired by the University;
- Increases the risk of non-compliance with University policies on the treatment of vendor rebates and incentives. According to Blink, department buyers and others are not to accept either incentives or offers for rebates from a supplier without the explicit advance approval of the Director, Procurement & Contracts. However, employees purchasing computers and other non-inventorial equipment via employee reimbursement may not be aware of this University policy; and
- Increases the risk that employees may not consider electronic equipment received to be University property.

Reimbursements Approved by Subordinates - *UC Accounting Manual Policy D-224-17, Delegation of Authority – Signature Authority*, states that proper separation of duties requires that individuals who approve transactions should have sufficient authority to disallow a transaction without being countermanded or subject to disciplinary action. Therefore, internal controls over reimbursements are weakened when the individual who is approving the transaction is someone who reports directly or indirectly to the individual being reimbursed.

During our review, we identified nine of 58 (16%) transactions where reimbursement approvers were subordinate to the payee. We were able to determine subordinate approval through a search of position titles on an individual basis during the course of testing.

Adequacy of Supporting Documentation - According to the reimbursement instructions on Blink, departments are required to submit all supporting documentation to Disbursements. However, during our transaction testing, we

***Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06***

noted there was not adequate supporting documentation on file for 11 of 58 (19%) of transactions tested. For example:

- A copy of the receipt for a purchase of \$3,875 in gift cards had not been received by Disbursements from the originating department prior to reimbursement approval.
- A waiver of the UCSD gift policy had been granted for a piece of art. Although the request for approval of the policy exception was documented, there was no documentation on file formally indicating that the exception had been approved or by whom.
- Guidance for mileage and parking reimbursements requires the location, dates, mileage rate and total expense amount, and specific business purpose be documented. However, during our testing of mileage reimbursements, the majority of requests did not provide this level of detail.

The lack of adequate supporting documentation puts the University at risk for fraud, and for disallowances in the event of an audit by external parties. For example, we noted one reimbursement for a laptop computer purchased within days of the reimbursed employee leaving the University. The documentation supporting the reimbursement includes Disbursements' inquiry regarding whether the laptop was University property. Disbursements was advised that the employee left the University and the laptop was not considered University property. Disbursements determined that the funding source was a federal training grant on which stipends (and allowances) are allowable expense types, and approved the reimbursement.

It is our opinion that this expense may be difficult to fully justify in the event of a federal audit. While the expense type would likely be justified as allowable, the expense may be difficult to justify as allocable to the award if there is not a clearly defined benefit to the federal award in the award period. This was not evident in the Payment Authorization documentation.

Compliance with Policy - During transaction testing, we identified four of 20 (20%) transactions that did not appear to be in strict compliance with University policy and guidance for third party services and sales and use tax.

According to *UC Accounting Manual Policy D-224-17, Delegation of Authority – Signature Authority*, an employee may not be reimbursed for payments to third parties for services, except for expenses incurred in connection with business travel and entertainment. Blink defines professional services as services performed by companies, such as corporations, firms, partnerships, and sole

***Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06***

proprietors. Blink defines personal services as infrequent, technical, or unique functions performed by individuals. During our review, we were advised by Disbursements that services may be reimbursed via Payment Authorization if original payments were made to companies rather than individuals. Therefore, Disbursements Payment Authorization restrictions are not in strict compliance with the UC Accounting Manual or Blink guidance which restricts purchases for all third-party services.

As part of our review, we evaluated whether sales and use tax was assessed on a sample of 20 Payment Authorizations. We determined \$754.87 of use tax had not been assessed on four of the 20 (20%) Payment Authorizations tested. Increased vigilance is required to ensure that use tax is assessed on items purchased from out of state vendors, and used within California, to reduce audit exposure for sales and use tax.

Primary responsibility for compliance with policy resides with the originating departments. Therefore, a thorough understanding of University policy and clear and consistent guidance at the originating department level are necessary to ensure compliance with applicable requirements.

Management Corrective Actions:

Disbursements will:

1. Issue an educational reminder to the campus community regarding the limited number of circumstances in which employees should be paid via Payment Authorization, and guidance on campus standards for acquiring goods and services. The reminder should note that repeat offenders of campus procurement standards may incur the risk that payments to employees may not be centrally approved.
2. Consider developing additional controls into the MyPayments system to encourage the proper procurement method, and compliance with all procurement policies in the use of MyPayments for payments to employees. These controls may include:
 - a. Warning signs for MyPayments transactions for restricted transactions, including non-inventorial computer equipment and third-party services, that should be processed via alternative procurement methods;
 - b. Warning signs to indicate MyPayments transactions that may exceed delegations of authority;

***Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06***

- c. Additional data entry requirements to ensure non-subordinate approvals and identification of use tax application.
 - d. A text field in MyPayments, in which departments are required to explain why the transaction could not have been completed via a traditional procurement method.
 - e. The use of continuous monitoring tools for MyPayments where system edits cannot be implemented.
3. Consider, in consultation with Procurement, requiring additional training for preparers with recurring improper method Payment Authorization reimbursement transactions.
 4. Ensure adequate mileage documentation has been received for mileage reimbursements including:
 - a. location,
 - b. dates,
 - c. mileage rate and total expense amount, and
 - d. specific business purpose.
 5. For reimbursement requests that appear questionable and Disbursements requires the department to provide justification, the documentation will be included in the transaction file.

B. Student Organization Fund Approval Processes

Disbursements did not require adequate supporting documentation and/or reconciliations for student organization withdrawal requests.

UC is committed to providing a supportive and enriched learning environment for all undergraduate, graduate, and professional students. UCSD campus activity fees support programming, student organizations, services, operations and sustainability efforts of the Associated Students of UCSD. UCSD student organizations are intended to connect students with a stronger sense of community while providing opportunities for students to engage in organizational and leadership development. The dollar amount of fees received by category limits the funding available by category.

***Payment Authorizations – Payments to Employees
Audit & Management Advisory Services Project 2012-06***

Because recognized student organizations may generate additional funds by fundraising activities, and may use their own funds without restrictions, Disbursements procedures did not require supporting documentation for any student organization payments (during our review period). One Payment Authorization tested was paid to an employee for a student organization activity funded by student activity fees of \$12,000. In accordance with Disbursements procedures at the time, the funding source was not evaluated and the student organization request was disbursed without any support or reconciliation requirement.

In general, student organizations have limited training and experience in financial management. Further, UCSD has a fiscal oversight responsibility to the student community to assist student government (Associated Students) in their oversight responsibilities for student funds. We have been advised the Disbursements will be requesting this additional support for future student organization Payment Authorizations.

Management Corrective Action:

Disbursements has defined procedures for student organizations to withdraw funds for events, and to reconcile financial activity within ten days after the event.