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Internal Audit Report

Service Contracts Administration

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I. EXECUTIVE SUMMARY

Internal Audit & Advisory Services (IAS) has completed an audit of service contracts to evaluate the effectiveness of the administration and oversight of campus service contracts for ensuring that services provided meet the terms and conditions of the contract and that services paid for have been received.

In general, campus invoice payment procedures and practices in place were effective in providing reasonable assurance that services met the terms and conditions of service contracts and those services paid for had been received.

However, the effectiveness of existing procedures is based on the premise that campus staff will forward invoices for approval and payment to those who are knowledgeable about the services provided. For many units, contracting with independent contractors/consultants is not common. These units must rely on someone, usually in the divisional business office, who knows the importance of the review and approval process and sets it up with the appropriate personnel who work with contractors. If these roles are not assigned and only assumed or if personnel who have had these roles leave their positions there is the risk that contractor invoices could be paid with no assurance that invoiced deliverables have been obtained.

In addition, there was a question raised during the audit about the risk of loss if maintenance contracts were not renewed in a timely basis. For maintenance contracts reviewed, there was contact with the vendors during the contract renewal period. This would appear to reduce our exposure to loss as it was customary for vendors to remind their clients to renew expiring contracts. Further, it is in the vendor's interest that services continue, as the university provides payment for those services.

There were no observations requiring management corrective action. Refer to APPENDIX A – Summary of Work Performed and Results for additional detail.

II. INTRODUCTION

Purpose

The purpose of the audit was to evaluate the effectiveness of the administration and oversight of campus service contracts for ensuring that services provided meet the terms and conditions of the contract and that services paid for have been received.

Background

There are different types of service contracts, such as contracts for independent contractors, consultants and others, for example vendors who provide maintenance services.

UC Policies: BFB-BUS-77 Independent Contractor Guidelines and BFB-BUS-34 Securing the Services of Independent Consultants provided the following definitions:

Independent Contractor: An independent contractor relationship exists when the University has the right to control only the result of the service, not the manner of performance.

Independent Consultant: An independent consultant relationship exists when the University does not control either the result of the service or the manner of performance.

Independent Consultant Agreement: A contract for services which are of an advisory nature, provide a recommended course of action or personal expertise, have an end product which is basically a transmittal of information either written or verbal, and which is related to University administration and management. BUS-77 also has a Professional Services Agreement template.

Much of BUS-77 provides a summary of the criteria used to determine a worker's status under Internal Revenue Service (IRS) common law standards and details the penalties imposed by the IRS for the misclassification of workers as independent contractors.

BUS-34 includes a template of the Independent Consultant Agreement

We were mainly interested in contract administration for consultants, as contract administration for this group should include additional scrutiny of invoices to ensure that invoiced work was actually done.

There were many documented procedures for setting up contracts/agreements/purchase orders, such as filling out the UCSC Independent Contractor Pre-Hire Worksheet to ensure IRS requirements are met, ensuring competitive bidding requirements are met, etc. Business Contracts & Procurement (BC&P) is responsible for ensuring these procedures are carried out.

BC&P's role ends with the completion of a purchase order, after which, FAST/Accounts Payable takes over as the next central business unit involved with a contract. Between these two there is the user unit who administers or manages the contract, ensuring that services are rendered and

accepted before invoices are paid. BC&P will also be called on for change orders and for remedies when contract disputes occur.

UC Terms and Conditions, Article 8 "Payment, Extra Charges" states: "UC will pay Supplier, upon submission of acceptable invoices, for...services rendered and accepted." This implies a process to ensure that services have been rendered and accepted before invoices are paid.

According to Financial Affairs' "Consultant Payment Guide,"

Each invoice must be reviewed and signed (i.e. approved) by an authorized departmental or divisional employee prior to its submission to the Financial Administrative Services and Transaction Office (FAST/AP) for payment.

According to Financial Affairs "Independent Contractor Payment Guide,"

A payment on an invoice associated with a purchase order coded with a "UCSC42" in the commodity description field must be reviewed and signed by an authorized departmental or divisional employee prior to its submission to the Financial Administrative Services and Transaction Office (FAST/AP) for payment.

Code UCSC42 is used to specify required review and approval by an authorized departmental or divisional employee prior to invoice submission to FAST for payment.

We learned that campus offices we contacted had an invoice process for ensuring that independent contractor invoices were reviewed to ensure invoiced work was delivered before payments were made. We also learned that for those offices with responsibility for maintenance service contracts, there is tracking of these contracts.

Scope

Our review focused on two risks. One was the risk of the payment of consultant/contractor invoices without the work being done, and the other was the risk of maintenance service contracts not renewed timely.

We contacted 13 campus offices during our preliminary survey and testing phases to learn about service contracts, the invoice payment process and maintenance service contract tracking. These offices were Business Contracts & Procurement, ITS Software Licensing, PBSci Research Resources, SocSci Research Administration, SocSci Financial Operations, BSOE Research Administration, BSOE Center of Biomolecular Engineering & Science, EH&S, BAS-Operations & Resource Management, Risk Services, Staff HR, Financial Affairs-Enterprise Financial Systems, UNEX, and the Library.

The BC&P assistant director provided us with a CruzBuy report on contracted services provided to the campus during FY 2014. We also generated an FIS Banner report for FY 2014 to identify

purchase orders for the services of consultants as well as other contractors. There were 75 purchase orders for consultant services that provided the base population for contracted services we would draw samples from for invoice payment testing at approximately 10 percent of the population by auditor judgment, mainly on contract dollar value. We chose two maintenance service contracts to test for timely renewal.

Procedures for testing contractor invoice payments included:

- Nine judgmental samples of consultant services (12 percent of population) plus three additional purchase orders with independent contractors.
- Identify who provide payment approval.
- Contact approver and obtain documentation, if possible, that invoiced work was determined to be complete before invoiced payment was approved.
- If work was not determined to be completed before the invoice payment was approved, find out why this occurred.

Procedures for testing maintenance service contract renewal:

- Two judgmental samples based on contract cost and impact on campus.
- Determine if the contract term was renewed timely.
- If there was a lapse, determine if this created a problem for those who depended on the vendor's services.

We excluded from our review consultant agreements that were construction or physical plant related, as we already have familiarity with the Physical Planning & Construction and Physical Plant invoice payment processes. Their invoice review and approval process is adequate, as invoices are reviewed and approved by project managers.

APPENDIX A – Summary of Work Performed and Results

Preliminary Survey	
Work Performed	Results
<ul style="list-style-type: none"> We discussed the scope of our review with Business Contracts & Procurement management. We surveyed 12 campus offices to learn of their invoice processes for contractors and tracking of maintenance/service contracts. We reviewed UC policies, such as BFB-BUS-77 Independent Contractor Guidelines and BFB-BUS-34 Securing the Services of Independent Consultants. We reviewed contract terms and conditions related to invoice payments, such as Article 8 "Payments, Extra Charges." We reviewed campus guidelines for payments of invoices, such as Consultant Payment Guide and Independent Contractor Payment Guide. We obtained a CruzBuy report on contracted services provided to the campus during FY 2014. We generated an FIS Banner report for FY 2014 to identify purchase orders for the services of consultants as well as other contractors. We reviewed two audits in which issues with contract administration had been noted. 	<p>The results of our preliminary survey were stated in the background section of this report.</p>

Contractor Invoice Payments	
Work Performed	Results
<ul style="list-style-type: none"> Nine judgmental samples of consultant services (12 percent of population) plus three additional purchase orders with independent contractors. Identify who provide payment approval. Contact approver and obtain documentation, if possible, that invoiced work was determined to be complete before invoiced payment was approved. If work was not determined to be completed before the invoice payment was approved, find out why this occurred. 	<p>Our testing demonstrated that the organizations that processed our samples of invoices were aware of the importance of first ensuring that invoiced work was completed before having invoice payments processed. All these organizations had an appropriate person who oversaw the work, such as a PI or campus management working with the independent contractor/consultant, provide an approval to pay. The invoice payment process ensured that such persons were provided with these invoices for their review and only sent to FAST to process payments when their approval was obtained.</p>

	<p>Academic divisions had invoice payment processes of the type we were looking for due to the common occurrence of independent contractors/consultants as subcontractors on research grants. Those units for whom contracts with independent contractors/consultants are not common, rely on someone, usually in the divisional business office, who knows the importance of the review and approval to pay invoice process and sets it up with the appropriate personnel who work with the contractor. If such roles are not assigned and only assumed, and if personnel who have had these roles leave their positions, there is the risk that contractor invoices could be paid with no assurance that invoiced deliverables have been obtained.</p>
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Maintenance Contract Renewal	
Work Performed	Results
<ul style="list-style-type: none"> Two judgmental samples based on contract cost and impact on campus. Determine if the contract term was renewed timely. If there was a lapse, determine if this created a problem for those who depended on the vendor’s services. 	<p>Even when maintenance/service contracts were not renewed before the expiration of the previous contract, the vendors did not discontinue their service.</p> <p>We concluded that an untimely renewal of maintenance contracts does not pose a risk to the campus, so long as we are in contact with the vendors during the contract renewal period. Contact is not difficult as it is a standard practice for vendors to remind their clients to renew expiring contracts. Further, it is in the vendor’s interest as well as the universities that service continues, as the university provides payment for those services.</p>