

UC MERCED INTERNAL AUDIT ANNUAL REPORT

Fiscal Year 2016–2017 in Review

Contents of Annual Report

<u>Description</u>	<u>Pages</u>
Overview and Highlights	3 - 5
Overview of Completed Projects	6 - 27
Significant and Recurrent Issues	28 - 29
Current Audit Environment	30
Management Corrective Actions	31
Annual Risk Assessment Process	32
Training and Presentations	33
Participation in Committees	34
Mitigating Risks in the Years Ahead	35

Overview and Highlights

Internal Audit strives to be a trusted advisor for UC Merced campus leadership. The mission of UC Merced Internal Audit is to help the University fulfill its mission of teaching, research, and service, by:

- Providing value added services that assist management in meeting their responsibilities and achieving established goals;
- Collaborating with internal customers so that services strengthen controls in order to mitigate risks and improve process efficiency and effectiveness; and,
- Ensuring compliance with University policies and external regulations.

Overview and Highlights

During FY 2016-2017,:

- Internal Audit issued seven audit reports and seven advisory service reports. Internal Audit worked with employees during audits and advisory services to identify distinct actions to strengthen internal controls and to improve the efficiency of processes.
- To provide expertise in cybersecurity, UCOP Internal Audit put together a Cybersecurity Audit Team. This team completed its first IT Security audit at UC Merced during FY 2016-2017.
- Internal Audit closely collaborated with Compliance and Risk Services to coordinate risk workshops as part of the annual risk assessment process.
- A portion of hours worked by Internal Audit included working with the Locally Designated Official (LDO) to complete fact-finding for various whistleblower hotline investigations.

Overview and Highlights

The following is a high level overview of how employee time was utilized by UC Merced Internal Audit during FY 2016 - 2017.

	FY 2017 Hours	% of Time FY 2017	% of Time FY 2016
Time spent on Audits	1,406	38%	51%
Time spent on Advisory Service Projects	1,173	32%	15%
Time spent on Investigations	89	2%	5%
Time spent on Audit Support Activities (e.g. Audit Risk Assessment, Quality Assurance Review, etc.)	<u>301</u>	<u>8%</u>	<u>6%</u>
Total Direct Time	2,969	81%	77%
Administrative, Professional Development, Training Employees, and other Indirect Hours	698	19%	23%
Total hours available	3,667	100%	100%

2016 - 2017 Audits

Based upon the Audit Risk Assessment completed during early 2016, systemwide requirements, and special requests, the following Audits were completed at UC Merced during FY 2016 - 2017:

- Staff Hiring Practices – Review of New Procedures
- Merit Pay Program
- Executive Compensation
- Moving Expenses
- UC Fair Wage / Fair Work Plan
- Vice Chancellor for Development and Alumni Relations Transition Review
- Management of Externally Funded Sponsored Programs
- Vulnerability Assessment and Penetration Test Audit (Performed by the Systemwide Cybersecurity Audit Team)

Staff Hiring Practices – Review of New Procedures

During 2014 and 2015, Campus Leadership requested that Internal Audit review staff recruitments for compliance with UC policies and Department of Labor requirements. During the resulting audits, Internal Audit concluded that UC Merced's staff hiring practices needed improvement as hiring documentation did not satisfactorily prove that hiring practices were unbiased and non-discriminatory.

To improve the hiring process for qualified candidates, new staff hiring procedures were implemented by Human Resources in July 2016 which were designed to set up control points and improve recruitment documentation. Internal Audit completed an audit to determine whether the new staff hiring procedures adequately prevented discriminatory hiring practices.

From our audit of recruitments after July 1, 2016, we concluded that the new hiring procedures were well-designed and operating effectively. The certification of the disposition process provided better evidence that selected candidates were qualified based upon the advertised job requirements. Sufficient evidence was reviewed to verify that the management corrective actions from the 2014 and 2015 audits had been completed.

Merit Pay Program

During FY 2016 – 2017, all UC locations were required to follow a merit-based pay program for non-represented staff employees. At the request of Campus Leadership, we completed an audit of the UC Merced merit pay program. The purpose of the audit was to verify that merit increases were accurately applied based upon the parameters approved by the Chancellor's Cabinet in March 2016.

Recommendations were made in the following areas:

- Reconciliation of division merit pools
- Senior Manager approval of employee merit increases
- Reconsider use of merit pool available from employee turnover
- Consistency of merit increase strategies
- Process difficulties with time lapse before merit pay increases

Executive Compensation

The purpose of this systemwide audit was to assess the effectiveness of processes in place to ensure accuracy of the Annual Report of Executive Compensation (AREC) and the Annual Reports of Expense of the Chancellor. The Regents' Compliance and Audit Committee request that this audit be completed annually at all UC locations.

It was determined that internal controls in the area were adequate and no issues were reported on this audit report.

Moving Expenses

The purpose of the audit was to determine whether UC Merced's spending for new employee relocations complies with UC policies and Internal Revenue Service (IRS) regulations.

We noted non-compliance with UC policies and recommended that responsibilities for handling moving expenses be centralized with one department. This should simplify reimbursement processes and improve compliance with UC Policies.

UC Fair Wage / Fair Work Plan

On July 22, 2015, University of California (UC) President Janet Napolitano announced a new minimum wage plan for UC employees. Titled the “UC Fair Wage/Fair Work Plan”, the program guarantees that by October 2017 UC employees hired to work at least 20 hours a week be paid at least \$15 per hour. To help enforce the plan requirements, Internal Audit departments at UC locations were tasked with periodically reviewing Procurement’s management of the Fair Wage/Fair Work Plan requirements.

This was the first audit of the plan. The purpose was to review that Fair Wage/Fair Work Plan requirements were being complied with. During this first audit of the Fair Wage/Fair Work provisions, UC Merced Procurement was in the midst of establishing procedures for identifying all contractors that fall under Fair Wage/Fair Work and for enforcing the certification requirements. While this first iteration ended up being a time-consuming process for Procurement, the department has now set up processes to identify and list all vendors responsible for the Fair Wage/Fair Work requirements and to follow up for audit certifications in a timely manner.

Vice Chancellor for Development and Alumni Relations Transition Review

This audit was completed in conjunction with a larger transition assessment of the Vice Chancellor for Development and Alumni Relations undertaken at the request of Campus Leadership. The primary purpose of the audit was to ensure that the accounts taken over by the next leader over the division are in order and present little future risk of controversy. A secondary purpose was to review that spending has been in line with budgets in order to avoid deficit balances in funds and accounts.

We identified potential process improvements in the following areas:

- Special Approvals and Exceptions to Policy
- Efficient Transaction Reviews and Approval
- Budget Funding for Commencement

Management of Externally Funded Sponsored Programs

The Council on Governmental Relations (COGR) put together a guidebook to help institutions review their management systems and internal controls in regard to managing sponsored programs. During this audit, Internal Audit compared the research administrative practices at UC Merced with COGR's recommended practices to identify areas for potential improvement. The purpose of the audit was to determine whether UC Merced has established adequate processes to effectively manage awards. The report has not yet been formally issued as Management Corrective Actions are still being finalized by the Office of Research.

Potential improvements were identified in the following areas:

- Review of proposals before submission and accurate proposals in Cayuse
- Consistent training expectations for Research Administrators
- Testing and dissemination of campus emergency plans
- Proactive training for effective compliance practices
- Formal risk assessments of subrecipients
- Disparities among Research Administrators in schools and organized research units
- Increased scrutiny over the allowability of equipment purchases
- Backup for employee completing analysis in specialized research areas
- Updating the Office of Research and Economic Development webpages and links

IT Security

The Systemwide Cybersecurity Audit Team (CAT) completed and issued the results of the UC Merced Vulnerability Assessment and Penetration Test Audit. The objective of this review was to identify vulnerabilities and perform penetration testing on a sample of systems at UC Merced to provide assurance that vulnerabilities are being managed appropriately to reduce cyber-risk.

Based on the results of the various assessments conducted for UC Merced, the CAT concluded that the internal and external networks were found to be vulnerable to penetration. UC Merced IT is working to fix the issues identified during the audit. The CAT will review work completed for management corrective actions to verify that the vulnerabilities are corrected.

Campus Safety Practices

During May through June 2017, Internal Audit completed the fieldwork for an audit of campus safety practices.

During this audit, we reviewed work practices and the Injury and Illness Prevention Plan (IIPP). We also reviewed access to campus buildings and student housing.

During July 2017, Internal Audit was requested to complete a corresponding advisory service related to governance over campus safety functions. As the issues identified during the Safety audit will require high level decisions related to governance over EH&S and other safety functions, the Safety audit report has not yet been issued.

Advisory Service Projects

Advisory Services are different from traditional audits. Advisory Services are internal consulting engagements where the purpose is to improve processes. The following definition is from the UC Audit Manual:

“Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include advice, facilitation, training and participation in on-going committees.”

The following Advisory Service Projects were completed:

Advisory Services Reports Issued

- Conflict of Commitment
- Use of University Vehicles
- UCPath Pilot Deployment Readiness
- Athletics Team Travel Card Review
- Leaves of Absence
- Sierra Nevada Research Institute
- Review of Campus Store Inventories

Completed without issuing a formal report

- Data Analytics Reviews
- Graduate Student Association Election Review
- Small Business Development Centers and Sponsored Research Services

Conflict of Commitment

The review was requested by the Associate Chancellor. The purpose of this review was to gain an understanding of the current conflict of commitment reporting procedures and to recommend ways to improve policy compliance and simplify processes. Internal Audit compared UC Merced processes with the reporting at other UC campuses.

Potential improvements were identified in the areas of improving written guidance and training of administrative staff.

Use of University Vehicles

The review was requested by the former AVC-Campus Safety. Internal Audit reviewed how UC Merced screens drivers before allowing them to drive a University-owned vehicle. We reviewed campus procedures related to these vehicles to identify unmitigated risks and ways to improve compliance with UC Policy.

We determined that UC Merced's procedures need to be redesigned. The procedures utilized were not sustainable with the growth of the campus. The report included recommendations under the following headings:

- Redesign processes so one sole employee isn't making decisions impacting an employee's ability to work
- New processes and approved written guidance are needed as current procedures are not sustainable as the campus continues to grow
- Improve management and purging of confidential information
- Expectations for drivers of university vehicles should be formally communicated
- Improve communication between departments during the DMV Pull process

UCPath Pilot Deployment Readiness

UC Merced Internal Audit completed the first of three planned assessments of UC Merced's preparations for the UCPath pilot deployment. This advisory service was completed as part of a larger project that included the UC Office of the President, the UCPath Center, and the three campuses involved with the pilot deployment (UC Merced, UCLA, and UC Riverside). The purpose of this Internal Audit project was to provide additional, independent operational readiness risk assessment and monitoring for the UCPath program pilot launches.

The report discussed potential improvements under the following headings:

- Improve communication between UC Merced business process owners and employees at other locations working through the same processes
- Continue to communicate to the campus and to business stakeholders
- Establish a Training Lead to work closely with department leads and stakeholders
- Employee workloads to prepare for UCPath

Athletics Team Travel Card Review

The review was requested by Athletics' Leadership. The purpose of the advisory service was to verify that internal controls have been appropriately designed to prevent misuse of the Athletics Team Travel cards.

Based upon our review of processes and card transactions, we concluded that Athletics had properly designed processes and internal controls to prevent card misuse.

Leaves of Absence

The review was requested by the Campus Locally Designated Official based upon an anonymous complaint received. The purpose of the review was to determine whether supervisors were asking employees to work during approved leaves of absence.

We did identify instances where employees had been requested to work during their leaves of absence. Based upon our findings during the review, we recommended that Human Resources and the Leaves Office consider implementing stronger measures to keep an employee from working during a leave of absence.

Sierra Nevada Research Institute

The review was requested by the Executive Director of the Sierra Nevada Research Institute (SNRI). Internal Audit completed a review of research administrative activities at SNRI. During the review, we analyzed the Institute's spending on awards and compared the results with other schools and Organized Research Units that manage awards. This helped identify the differences in administrative workloads.

We recommended potential improvements to processes under the following headings:

- Organization of Departmental Research Administrators and Administrative Staffing
- Approvals and Monitoring Spending
- Formal Training for Department Research Administrators

Review of Campus Store Inventories

The review was requested by the VC-Student Affairs. The campus store inventories greatly increased during FY 2017. The purpose was to review controls over inventories and to verify that inventories were accurately reported.

While inventories have increased, Internal Audit noted adequate physical controls over inventories and accurate reporting of inventory. To get inventory levels under control, we recommended:

- Steps should be taken to review sales levels, plan for purchases, and establish reorder points for different items.
- Monthly (or periodic) inventory test counts should be completed at the outside warehouse.
- Review physical security over computer equipment (i.e. apple computers being held for sale).

Data Analytics Reviews

Throughout the year, Internal Audit analyzed data regarding financial transactions at UC Merced. The transactions included payroll, payments to vendors, employee reimbursements, purchase card purchases, and Travel and Entertainment card transactions. We reported the results of our analysis to members of the ECP Executive Committee during September 2016 and January 2017. The first report was a summary of transactions during FY 2015-2016 and the second report was about trends and fraud risks that should be considered as part of the annual risk assessment.

The analysis completed for these reports was shared with other UC Internal Audit departments and similar projects are now being completed at other campuses.

Graduate Student Association Election Review

After there were complaints about a Graduate Student Association (GSA) special election, Internal Audit was requested to provide an independent review of the election procedures and results. The review was requested by the VC-Student Affairs and Dean of the Graduate Division.

A memo summarizing our work and conclusions was provided to the VC-Student Affairs and to the Graduate Dean. (As complaints regarding this election later reached the UC Office of the President, Internal Audit later provided this memo to the Interim SVP and Chief Compliance and Audit Officer at UCOP and to other UC Merced Campus Leadership.)

Small Business Development Centers and Sponsored Research Services

The review was requested by the VC-Research. There was a disagreement between the Small Business Development Center (SBDC) staff and Sponsored Research Services (SRS) staff regarding issues on the SBDC annual report that was late in being submitted to the Small Business Administration. Internal Audit was tasked with reviewing both sides of the dispute and recommending a plan for resolving the disagreement.

Internal Audit provided a memo of our findings and recommendations to the VC-Research.

Fact Finding for Investigations

At the request of the Associate Chancellor (Locally Designated Official), Internal Audit completed fact-finding related to Whistleblower Hotline complaints during the year. Internal Audit compiled the results of our fact finding and presented them to the Associate Chancellor so she could determine whether the complaint required a formal investigation.

During the year, Internal Audit completed fact-finding regarding four separate Whistleblower Hotline complaints.

A Quality Assurance Review regarding Investigations managed by UC Internal Audit departments was completed during the year. UC Merced Internal Audit generally conforms with the Internal Audit standards regarding investigative work and reporting results.

Significant and Recurrent Issues

From audits, advisory services, investigations, the annual audit risk assessment, and discussions with employees, significant and recurrent issues were noted in the following areas:

1. Poor coordination of Emergency Planning and Business Continuity Planning
2. Lack of written guidance (formal campus procedures)
3. Insufficient resources in campus risk and safety functions
4. Lack of redundancy for many key areas (only one employee completing specialized functions)
5. Lack of consequences for violating policies

Progress on Prior Year Issues

UC Merced is making progress in improving processes related to significant and recurring issues noted during prior years. The following are examples of issues reported during various prior years.

- IT Security – During past years, IT Security was identified as a recurring issue. During recent years, UC Merced has increased resources dedicated to IT Security. During 2017, Optiv consultants completed an IT Risk Assessment at UC Merced. IT continues to improve (and formally document) their processes.
- Staff Hiring Practices – During past years, issues were identified with the campus's hiring practices. During 2016, Human Resources issued new procedures and added recruiting staff to provide better guidance over the hiring process.

Current External Audit Environment

During recent years, Internal Audit has increased the time devoted to external audit coordination in order to minimize the disruption to the campus caused by external audits.

During the last two fiscal years, the California State Auditors (CSA) have completed four large audits of the University of California. UC Internal Audit departments spent a significant amount of time managing information requests and the CSA audit process related to these audits.

Overall, the lesson to be learned from the audits is that UC Merced needs to continue to be diligent in considering the potential impact of actions and decisions. It is important to comply with UC Policy and to consider the potential negative publicity that could result from how we utilize state funds and other funds with restrictions.

Management Corrective Actions

When control issues are identified during audits, Management Corrective Actions (MCA's) to fix the issues are set up and tracked by Internal Audit until completion. The Compliance and Audit Committee of the Regents reviews progress towards fixing incomplete MCA's related to high risk issues and MCA's older than 300 days (from the time that the issues were originally reported.)

During the year, UC Merced completed MCA's related to the 2015 Hiring Audit and other audits. Currently, the only High Risk, Past Due MCA's relate to a Laboratory Safety Audit completed during 2015. Both MCA's relate to setting up a formal process for notifying Deans and Campus Leadership regarding uncorrected Lab Safety issues. The Academic Senate is to discuss the proposed campus procedures during September 2017.

Coordinated Risk Assessment

Internal Audit continues to work closely with Compliance to improve how UC Merced identifies and communicates risks to Campus Leadership. The following are highlights from the risk assessment:

- During February through April 2017, Internal Audit worked with Compliance and Risk Services to complete the annual risk assessment.
- The Risk Workshops brought together 63 staff employees from all divisions and schools. The meetings included organized brainstorming to identify high level risks at UC Merced and the perceptions of how well these risks are currently managed.
- The Audit Director met with the Provost and Vice Chancellors to discuss high-level strategic risks impacting UC Merced.
- Based upon the results, Internal Audit put together the FY 2017 – 2018 Audit Plan which is coordinated with the ongoing work of Compliance and Risk Services.
- A presentation of UC Merced's Risk Assessment process was presented to the UC Risk Partners and to the Compliance and Audit Committee of the Regents.

Internal Audit Training and Presentations

One purpose of Internal Audit is to improve the organization's control environment by educating employees about internal controls. Throughout the year, UC Merced Internal Audit made the following presentations:

Financial Management Certification Program (FMCP)

- The Control Environment, Internal Controls, and Monitoring
- Risk Management
- “Audit-Proofing Your Department” – Overview of the Audit Process

UC Systemwide Webinars

Lessons from a Fraud Investigation (Presented to UC Internal Audit)

UC Merced Staff Hiring Process – Working Across Functional Divides to Build Strength and Reduce Risk (Presented to UC Compliance)

Annual Risk Assessment Workshops

Discussed risks and controls with employees from various departments and schools

Monthly MSO Meetings

Presentations to MSO's regarding issues noted and ways to improve controls

Internal Audit Participation on Committees

To promote the control culture at UC Merced, Internal Audit participates in the following committees:

- Information and Privacy Security Committee (IPSC) – Serves as campus “GERI” (General Counsel, Ethics and Compliance, Risk, and IT) committee required by President Napolitano
- Ethics and Compliance Program
 - Executive Committee
 - Management Council
 - Financial and Operations sub-committee
- Investigations workgroup
- Research Misconduct Investigations Group (Structure has been put in place for when it will be needed)
- Data Analytics Subject Matter Experts – UCM Internal Audit coordinates the monthly meetings of the UC-wide group dedicated to increasing the use of Data Analytics by UC Internal Audit departments

Mitigating Risks in the Years Ahead

UC Merced Internal Audit continues to mature as a function. Other UC campuses have Internal Audit departments that range in staffing levels from 5 (UC Santa Cruz) to 33 (UCLA) audit professionals.

Our two-person staff continues to fulfill all requests for special projects from UC Merced's Campus Leadership and to adequately handle the required systemwide audits. To do this, we limit the scope of projects and end up issuing many more reports (per auditor) than other campuses.

One Internal Audit Standard is that auditors do not perform audits in areas in which we do not have the necessary level of knowledge / expertise to adequately understand risks and controls. As current staff does not have expertise with IT auditing, it will be helpful that the systemwide Cybersecurity Audit Team will continue to complete IT Security-related audits at UC Merced.

Internal Audit staff will continue to gain knowledge of important areas through training and participation in professional organizations. When areas of risk need the expertise beyond our knowledge, we will notify the Campus Audit Committee of the need to bring in outside expertise.