# UC MERCED INTERNAL AUDIT ANNUAL REPORT

Fiscal Year 2015–2016 in Review

# Contents of Annual Report

# Overview and Highlights

The mission of UC Merced Internal Audit is to help UC Merced 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 2015-2016,:

- Internal Audit issued nine audit reports. Various advisory services (internal consulting) projects were completed, although written reports were not issued for these projects.

- Internal Audit closely collaborated with Compliance and Risk Services to coordinate risk workshops as part of the annual risk assessment process.

- A significant portion of hours worked by Internal Audit included working with the Locally Designated Official (LDO) to complete fact-finding for various whistleblower hotline investigations.

- 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.  Management corrective actions were set up to be tracked until completion.

# Overview and Highlights

The following is a high level overview of how employee time was utilized by UC Merced Internal Audit during FY 2015 - 2016.

| | FY 2016 Hours | % of Time FY 2016 | % of Time FY 2015 |
|---|---|---|---|
| Time spent on Audits | 1,835 | 51% | 44% |
| Time spent on Advisory Service Projects | 552 | 15% | 19% |
| Time spent on Investigations | 172 | 5% | 6% |
| Time spent on Audit Support Activities (e.g. Audit Risk Assessment, Quality Assurance Review, etc.) | 227 | 6% | 5% |
| Total Direct Time | 2,786 | 77% | 74% |
| Administrative, Professional Development, Training Employees, and other Indirect Hours | 828 | 23% | 26% |
| Total hours available | 3,614 | 100% | 100% |

# Current External Audit Environment

Internal Audit works to minimize the disruption caused by external auditors. During FY 2016, the California State Auditors (CSA) completed two 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 two audits:

- UC Merced was one of three UC campuses included in an audit where the CSA evaluated the impact of UC and CSU campuses on local property tax revenues. The audit began in July 2015 and the audit report was issued during March 2016. The audit did not identify issues to report.

- The CSA included all UC campuses in an audit of enrollment, executive compensation, and budget practices. The audit began in July 2015 and the audit report was issued during March 2016. The audit identified many issues and resulted in poor publicity for the UC system.

# Current External Audit Environment

During recent months, the California State Auditors have announced three more audits that will impact the UC system:

- Audit #2016-125 "University of California – Contracted Employees and Contracting Practices"
- Audit #2016-114 "High School Coursework Access"
- Audit #2016-130 "University of California Office of the President – Administrative Expenditures"

Based upon the tone of the March 2016 enrollment audit report, UC Merced should be prepared for increasing scrutiny by the California State Auditors.

# Coordinated Risk Assessment

- During February through March 2016, Internal Audit worked with Compliance and Risk Services to complete the annual risk assessment.
- The Risk Workshops brought together 80 staff employees from all divisions and schools.
- They organized brainstorming to identify high level risks at UC Merced and the perceptions of how well these risks are currently managed.
- Based upon the results, Internal Audit put together the FY 2016 – 2017 Audit Plan which is coordinated with the ongoing work of Compliance and Risk Services.

# Annual Audit Risk Assessment

During the annual audit risk assessment, Internal Audit focuses on significant, auditable risks and inefficient processes. To evaluate potential areas for audit, Internal Audit considers five characteristics of an area or process:

- **Quality and Stability of Control Environment** *(Does the area have effective management? Have problems been noted in this area in the past? Have there been changes in this area that might increase risk?)*
- **Business Exposure** *(Based upon revenues and expenditures, how large is the potential loss in this area?)*
- **Public and Political Sensitivity** *(What is the potential for bad or embarrassing publicity that would hurt the University's reputation?)*
- **Compliance Requirements** *(Is the area subject to external policies and regulatory matters which could result in monetary losses, litigation or the loss of funding sources?)*
- **Information Technology and Management Reporting** *(Is the University's IT able to provide information that is accurate, available, timely, and useful for management?)*

# 2016 Audits completed based upon 2015 Audit Risk Assessment

Based upon the Audit Risk Assessment completed during early 2015, systemwide requirements, and special requests, the following Audits were completed during FY 2015 - 2016:

Audits

- IT Disaster Recovery Planning
- Laboratory and Field Safety
- Records Management Practices
- Workers' Compensation Insurance Practices
- Low Value Purchases and Expense Reimbursements
- Executive Compensation
- Classroom and Office Building 2 Construction Project
- Office of Financial Aid and Scholarships
- Dining Services

# IT Disaster Recovery Planning Audit

The purpose of this audit was to review UC Merced's current IT disaster recovery planning and to recommend potential improvements.

The following areas for improvement were identified:

- Campus leadership support and sponsorship.
- Formal risk assessment and business impact analysis.
- Disaster recovery strategy and formal plan.
- Testing and plan maintenance.

# Laboratory and Field Safety

The purpose was to evaluate how UC Merced identifies and mitigates risks related to research conducted in laboratories and at locations away from campus.

The following areas for improvement were identified:

- Annual lab inspections and correcting identified issues.
- Improving controls over chemical inventories.
- Safely removing hazardous waste.
- Improve monitoring of safety training.
- Maintaining physical security over laboratories.
- Identifying when research will be conducted at off-site locations.

# Records Management Practices

The purpose was to assess UC Merced's governance over paper and electronic records, including the identification, storage and retention, protection, and disposition of university records.

The audit report recommended designating a Records Management Coordinator to establish a campus-wide Records Management program. This will work to improve the following areas where weaknesses were identified:

- Lack of guidance regarding local campus records management procedures
- Ineffective management of paper records by some departments
- Lack of guidance regarding electronic records

# Workers' Compensation Insurance Practices

The purpose was to review procedures related to managing workers' compensation insurance claims and to identify the causes of increasing rates.

The following areas for improvement were identified:

- Poor control over the amount of time required before employees return to work.
- Ineffective review and monitoring of claims.
- Untimely follow up for employee ergonomics-related issues.

# Low Value Purchases and Expense Reimbursements

The purpose was to review controls over low value purchasing and reimbursements to employees.

The following areas for improvement were identified:
- Better utilization as a campus of purchasing cards.
- Updating and removing out of date campus procurement procedures.

# 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.

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

# Classroom and Office Building 2 Construction Project

This campus audit was part of the systemwide audit that was requested by the Regents. The purpose of this audit was to assess the effectiveness of construction management policies and procedures and internal controls and processes related to the administration of construction activities and, specifically bidding, change order and funding requirements.

It was determined that internal controls in the area were adequate and no issues were reported on this campus audit report. Statistics related to change orders on UC Merced construction projects during the recent years were completed and will be compiled for the systemwide report.

# Office of Financial Aid and Scholarships

The purpose of this audit was to evaluate the effectiveness of the internal controls established for the management of student financial aid at UC Merced.

The audit determined that the Office of the Financial Aid and Scholarships is a very well managed department at UC Merced. It was determined that internal controls in the area were adequate and no issues were reported on this audit report.

# Dining Services

The purpose was to evaluate whether Dining Services is effectively managing significant risks and internal controls in the areas of payments, inventories, and food safety.

The following areas for improvement were identified:

- Sustainable and compliant food safety measures.
- Efficiency of food management practices.
- Control over receiving and maintaining food and supplies inventories.
- Delegated purchasing authority.
- Dual custody of cash.

# Advisory Service Projects

Based upon special requests from departments, the following were the more significant Advisory Service Projects completed (reports were not issued for these projects):

Advisory Services
- Additional uses of Data Analytics
- Administration Coordination Team (ACT) and Post Authorization Notifications (PAN's)
- Conflict of commitment policy
- Small Business Development Center (SBDC) Sub-recipient Monitoring and preparation for Small Business Administration (SBA) review (fieldwork during August 2016)
- Admissions' implementation of improvements recommended during their external review

# Significant and Recurrent Issues

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

1. Override of policies and controls (policy exceptions and/or no consequences for not following policies)
2. Poorly documented hiring and promotions putting the campus at risk of discriminatory Human Resources practices
3. Impact on controls and governance from turnover of key staff and restructuring of departments
4. Identified laboratory safety issues not corrected timely
5. Business continuity planning and disaster recovery planning

# Significant and Recurrent Issues

**Comment regarding override of policies, campus procedures and controls (policy exceptions and no consequences for not following policies)** - During the year, Internal Audit noted various instances where policies and campus procedures were not followed or ignored. The following are some examples:

- Purchases by employees without purchasing authority
- Hiring without obtaining offer letters from Human Resources and without documenting why a candidate was selected
- Waivers of recruitment
- Travel and entertainment reimbursement policy exceptions
- Uncorrected laboratory safety issues
- Behavior by supervisors which result in disgruntled employees, terminations, and severance payments

Overall, we noted areas were there was a culture of policy exceptions and lack of accountability ("The exception is the rule…").

Risk – While waivers of recruitment and policy exceptions are instances where management "accepts the risks" related to unusual circumstances, these instances could result in poor publicity for UC Merced. External Auditors (like the California State Auditors) and the Press usually focus on policy exceptions and where an organization overrides its own policies and procedures.

How issue is being addressed - Improving monitoring of transactions and quarterly reporting of issues to the Ethics and Compliance Program committees; New recruitment procedures by Human Resources; Proposed reporting to Deans and Leadership regarding uncorrected laboratory safety issues

# New MCA's and Progress on MCA's

During FY 2016, new audit management corrective actions (MCA's) were added in the following areas:

- Improved reporting of identified Laboratory Safety Issues
- Governance over workers' compensation insurance
- IT disaster recovery planning
- Coordination of the campus's records management
- Improved controls over inventories

# Completion and Progress with MCA's

The following are some highlights from FY 2015 – 2016:

- Back in 2010, audit management corrective actions were set up to fix the cooling and backup power for the Telecommunications Building Data Center. During FY 2016, these MCA's were cleared.

- During FY 2014 - 2015, MCA's were set up after a campuswide Hiring Audit. On July 1, 2016, Human Resources set up new staff recruitment procedures. Internal Audit will continue to monitor recruitments to verify that the new procedures are followed and whether the risks have been mitigated.

- A new campus Records Manager was hired in Business and Administrative Services.

- Procedures to reduce workers' compensation insurance costs were implemented.

# Training in Controls

Throughout the year, Internal Audit was involved with training UC Merced employees and others regarding ways to improve internal controls. The following presentations were completed:

Monthly MSO Meetings
Monthly presentations to department MSO's regarding issues noted and ways to improve controls as part of the monthly "Internal Audit Director's Corner"

Financial Management Certification Program (FMCP)
Completed presentations in the following areas:
- The Control Environment, Internal Controls, and Monitoring
- IS-3 – Information security and confidentiality
- "Audit-Proofing Your Department" – Overview of Audit Process

Annual Risk Assessment Workshops
Discussed risks and controls with employees from various departments and schools

# 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 – Serves as campus "GERI" (General Counsel, Ethics and Compliance, Risk, and IT) committee required by President Napolitano

- Investigations workgroup

- Ethics and Compliance Program
    - Executive Committee
    - Management Council
    - Financial and Operations sub-committee

- Staff Assembly Committees
    - Staff Training
    - Affirmative Action/EEO

- 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

# Increasing Benefit from Internal Audit

Periodic reporting to campus audit committee of results from data analytics and audit monitoring. Internal Audit has set up testing in the following areas:

- Potential conflicts of interest with employee/vendor relationships
- Review of monthly payments for unusual and potential duplicate payments
- Review of purchase card activity
- Review of Travel and Entertainment card activity
- Payments and reimbursements to employees
- Disposition of staff recruitments
- Financial analysis of spending

Internal Audit will continue to work closely with the Controller's Office and other campus departments to expand the use of data analytics in controls monitoring.