

UC MERCED INTERNAL AUDIT ANNUAL REPORT

Fiscal Year 2017–2018 in Review

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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.

During the year, Internal Audit issued nine audit reports and three advisory service reports. We worked with employees during audits and advisory services to identify distinct actions to strengthen internal controls and to improve the efficiency of processes.

Overview and Highlights

The following is a high level overview of how employee time was utilized by UC Merced Internal Audit during FY 2017 - 2018.

	FY 2018 Hours	% of Time FY 2018	% of Time FY 2017	% of Time FY 2016
Time spent on Audits	1,738	49%	38%	51%
Time spent on Advisory Service Projects	899	25%	32%	15%
Time spent on Investigations	0	0%	2%	5%
Time spent on Audit Support Activities (e.g. Audit Risk Assessment, Quality Assessment Review, etc.)	<u>299</u>	<u>8%</u>	<u>8%</u>	<u>6%</u>
Total Direct Time	2,936	82%	81%	77%
Administrative, Professional Development, Training Employees, and other Indirect Hours	644	18%	19%	23%
Total hours available	3,580	100%	100%	100%

2017 - 2018 Audits

Based upon the Audit Risk Assessment completed during early 2017, systemwide requirements, and special requests, the following audits were completed at UC Merced during FY 2017 - 2018:

- Cash Management Controls
- Downtown Campus Center Construction Project
- Executive Compensation
- UC Fair Wage / Fair Work Plan
- Low Value Purchase Orders and Purchase Cards
- Employee Reimbursements
- Theft Sensitive Equipment and Supplies
- Vice Chancellor for Planning and Budget Transition Review
- Vice Chancellor for Business and Administrative Services Transition Review
- Post Award Spending

Cash Management Controls

The purpose of the audit was to review controls over cash and payments received by the University. The review was designed to determine whether sufficient internal control measures are in place to prevent or detect inappropriate, non-compliant and/or fraudulent transactions, while ensuring efficient and effective operations.

We identified opportunities for improvement in the following areas:

- Variances from policy should be reviewed by the Campus Cash Handling Coordinator
- Establish accountability for video surveillance security systems

Downtown Campus Center Construction Project

The audit evaluated the Downtown Campus Center Construction project. The building was occupied in early 2018. The purpose of the audit was to assess the adequacy of internal controls and construction management processes in the following areas:

- Bidding and award process;
- Contractual requirements, payments and change order execution;
- University Controlled Insurance Program (UCIP); and,
- Funding restrictions and requirements.

As a result of our review, we recommended a way to improve compliance with the University Controlled Insurance Program.

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.

UC Fair Wage / Fair Work Plan

On July 22, 2015, University of California 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 second annual audit of the plan. The purpose was to review that Fair Wage/Fair Work Plan requirements were being complied with. We verified that UC Merced Procurement has 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.

Low Value Purchase Orders and Purchase Cards

Based upon risks identified during data analysis, Internal Audit completed an extensive campus-wide audit that evaluated decentralized purchasing controls in departments. During the audit, we reviewed the use of purchase cards, low value orders, and “One Time Payee” payments by 59 different departments.

We concluded that departments are effectively managing their decentralized purchasing authority and low value purchasing. The Procurement department is currently working to set up a new procurement system and to put new processing workflows in place. These significant changes will impact how departments complete low value purchasing.

We recommended improvements in the following areas:

- Control over gift card purchases
- Restricted items inappropriately purchased on low value orders
- Inconsistent payment of sales/use tax
- Risk-based procedures related to receiving

Employee Reimbursements Audit

After identifying potential issues during a cursory review of reimbursements with data analytics, a more in-depth audit of employee reimbursements was completed at the request of the Campus Audit Committee.

The audit identified instances where poor review processes resulted in duplicate reimbursements and where documentation did not provide sufficient evidence that expenses were actually incurred by employees. Although there are areas for improvement, in most cases, procedures and controls appeared to be operating effectively.

Our recommendations were organized under the following headings:

- Insufficient review processes
- Late reimbursement requests
- Accruing sales/use tax on items purchased via reimbursement

Theft Sensitive Equipment and Supplies

The audit was completed to review the effectiveness of internal controls related to theft sensitive equipment and Facilities' parts inventories. The audit reviewed campus wide procedures as we reviewed theft sensitive equipment purchased and managed by 57 different departments.

During the audit, we noted very different levels of control over theft sensitive equipment by departments. We recommended ways that Procurement and Equipment Management could improve control over this equipment. We also recommended how Facilities could put cost effective procedures in place for controlling spare parts and materials.

Vice Chancellor Transition Reviews

Two separate audits were completed in conjunction with larger transition assessments of the areas formerly managed by the Vice Chancellor for Planning and Budget and the Vice Chancellor for Business and Administrative Services. The reviews were undertaken at the request of Campus Leadership. The primary purpose of the audits was to ensure that the accounts taken over by the next leaders over the areas 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.

The reports discussed the results of past internal audit engagements and highlighted potential issues related to departments, which were afterwards assigned to the Chief Financial Officer and the Chief Operating Officer.

Post Award Spending

The purpose of the audit was to review that internal controls prevent unallowable costs from being charged to awards. In order to evaluate the work of department research administrators, the audit scope included awards from all three schools and from the Sierra Nevada Research Institute and Health Sciences Research Institute.

The audit identified areas for improvement regarding how expenditures are coded when charged to awards, the periodic reconciliations of amounts charged to awards, and the incorrect calculations of indirect costs. We also identified where inadequate employee separation procedures resulted in the loss of documentation related to spending on awards.

[The final report has not yet been issued for this audit.]

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

- Governance over Campus Safety Functions
- UCPath Pilot Deployment Readiness
- Review of STEP Program Compliance

Completed without issuing a formal report

- Reviews of divisions as part of Vice Chancellor Transition Reviews
- Fraud Risk Program and Data Analytics Reviews

Governance Over Campus Safety Functions

The review was requested by the Associate Chancellor. The purpose of the review was to identify best practices for governance and reporting for:

- Environmental Health and Safety
- Risk Management
- Building Inspection Services
- Fire Safety
- Business Continuity Plan Management; and,
- Emergency Planning and Management.

Based upon the review of safety areas at other universities, Internal Audit recommended different reporting structures for safety functions that could improve efficiency, communication, and overall risk mitigation.

UCPath Pilot Deployment Readiness

UC Merced Internal Audit completed the second assessment 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.

During the first assessment completed during December 2016, the following themes were identified:

- 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

During the second assessment completed during September 2017, concerns were discussed regarding paycheck accuracy. Also, the time needed for testing and data validation was becoming compressed as test cycles began to significantly overlap.

Review of STEP Program Compliance

An advisory service was completed to review compliance with award requirements in the Strengthening Talents and Exploring Pathways (STEP) program. The review was requested by the Vice Chancellor for Student Affairs. During the review, Internal Audit reviewed the grant from the point of view of a Department of Education auditor in order to identify potential risks and areas for improvement.

We concluded that the Program Administrator in Student Affairs needed to collaborate with the Office of Research to improve compliance with applicable University policies and procedures, and sponsor requirements.

The report discussed recommendations under the following headings:

- Lack of documentation to support achievement of objectives
- Inadequate monitoring and accountability over grant funds

Incident Response Process Review

The Cybersecurity Audit Team (CAT) at UCOP has been set up to provide special expertise in the area of IT security. During FY 2017 – 2018, the CAT completed a cybersecurity incident response process review at all UC campuses. The objectives of the review were to:

- Obtain and analyze Location Incident Response Plan (IRP) and identify presence of key process elements.
- Determine the degree of awareness of the IRP and identify the presence of key incident response relevant roles at each location.
- Determine the effectiveness of the cybersecurity incident prioritization process and identify challenges, if any.

The results of the review have not yet been reported to the campus stakeholders.

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. Cybersecurity risks
2. Lack of ownership of emergency planning, business continuity, and other safety requirements
3. Poor compliance with regulations could result in fines or disruptive internal audits
4. Poor management of employee turnover and employee separation procedures
5. Difficulties with managing grant proposals and awards, and employee turnover among Research Administrators, could make it more challenging to manage the continuing growth of research

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.)

The following shows the progress made related to MCA's during the year:

- UC Merced completed MCA's related to the 2016 Laboratory Safety Audit. Both MCA's related to setting up a formal process for notifying Deans and Campus Leadership regarding uncorrected Lab Safety issues.
- IT hardened systems by completing IT Security MCA's identified during a 2016 audit by the UCOP Cybersecurity Audit Team.

Presentations and Committees

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

Data and the Annual Risk Assessment Process (Presented to UC Internal Audit)

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

- Ethics and Compliance Program
 - Executive Committee
 - Management Council
 - Information and Privacy Security Committee (IPSC)
- Investigations workgroup
- Data Analytics Subject Matter Experts – UCM Internal Audit coordinates the meetings of the UC-wide group dedicated to increasing the use of Data Analytics by UC Internal Audit departments

Internal Audit Quality Assessment Review

UC Merced Internal Audit is part of the UC Internal Audit function. Reporting to the Regents Compliance and Audit committee, UC Internal Audit is made up of audit departments at UCOP, the different campuses/health sciences, and at Lawrence Berkeley National Laboratory.

Internal Audit Standards require that Internal Audit departments establish a program for periodically evaluating that internal audit is conforming to the international standards and that steps are taken to assess and improve the audit function. Every five years, UC Internal Audit completes an internal assessment and an external assessor evaluates whether they agree with the conclusions reached. During FY 2017 – 2018, the accounting firm, Baker Tilly, and a group of Chief Audit Executives from other Universities reviewed UC Internal Audit and concluded that the audit function generally conforms with the Institute of Internal Auditors Standards and Code of Ethics.

The following were the strengths identified during the external review:

- Responsiveness of the Internal Audit Plan
- Relationships with stakeholders and management
- System-wide cybersecurity capabilities within Internal Audit
- Continuous successful performance and evolution
- Creative staff development approaches
- Use of subject matter experts

The following were the opportunities for improvement:

- Further define Internal Audit, Compliance, and Risk
- Evolve annual risk assessment discussions and clearly link Internal Audit activities to system and campus strategies
- Build out the use of data analytics
- Clarify UCOP Audit Services leadership roles

Providing Value to UC Merced

The mission of Internal Audit is to enhance and protect the University's value by providing risk-based and objective assurance, advice, and insight.

As part of the Quality Assessment Review process, UC Merced Internal Audit identified the following areas for improvement which will help us to provide value to our growing campus:

- **Communicating with Campus Leaders** – Further seeking feedback from campus leaders regarding risks and concerns
- **Communicating how audit projects relate to campus strategies** – Further explain how projects help mitigate risks identified during the annual risk assessment
- **Increasing Internal Audit “presence”** – Increase efforts to participate in campus committees and to meet with UC Merced employees