Sales and Services Revenue

December 2016          FY16 - #08

Submitted to:
See reverse.

Copies to:
Institutional Internal Audit Review Board
Audit Committee, Arizona Board of Regents
Robert C. Robbins, President
Andrew C. Comrie, Senior Vice President for Academic Affairs and Provost
Jon Dudas, Senior Vice President, Senior Associate to the President and Secretary of the University
Gregg Goldman, Senior Vice President for Business Affairs and Chief Financial Officer
Laura Todd Johnson, Senior Vice President, Legal Affairs and General Counsel
Leigh A. Neumayer, Interim Senior Vice President for Health Sciences
Karen A. Williams, Vice President for Information Strategy and University Libraries
Duc D. Ma, Interim Associate Vice President, Financial Services Office

Issued by:  Sara J. Click, CPA, Chief Auditor
             Internal Audit Department
Submitted to:
Arizona Research Labs
  Kimberly Andrews Espy, Senior Vice President for Research
  Caroline M. Garcia, Associate Vice President for Research
  Robert M. Quiroz, Manager, Finance and Administration

College of Agriculture and Life Sciences
  Shane C. Burgess, Dean
  Jeffrey M. Ratje, Associate Dean, Finance and Administration

School of Animal and Comparative Biomedical Sciences
  Andre-Denis Girard Wright, Director
  Hanh Do, Manager, Finance and Administration

College of Medicine - Phoenix
  Guy Reed, Dean
  Judith M. Apostolik, Executive Director, Finance

College of Medicine - Tucson
  Charles B. Cairns, Dean
  David T. Elmer, Deputy Dean, Financial and Business Affairs
  Pamela H. Ray, Assistant Dean, Financial Affairs
  Valerie A. Ellis, Business Manager, Senior
  Barbara A. Hall, Special Assistant, Projects
  Randa M. Kutob, Director, Continuing Medical Education

College of Engineering
  Jeffrey B. Goldberg, Dean
  Lisa N. Rulney, Assistant Dean, Finance and Administration

Aerospace and Mechanical Engineering
  Jeffrey W. Jacobs, Department Head
  Nancy E. Preble, Manager, Administration and Finance

Planning, Design and Construction
  Peter Dourlein, Assistant Vice President
  Bruce M. Vaughan, Director, Real Estate
  Jodie Y. Kwong, Assistant Director, Business Services

Marketing and Brand Management
  Tony Proudfoot, Association Vice President of Marketing and Brand Management
  Alixe Holcomb Gustafson, Director, Trademarks and Licensing

College of Science
  Joaquin Ruiz, Dean, College of Science, and Executive Dean, College of Letters, Arts and Science
  Kelly J. Grimm, Assistant Dean, Business and Finance

Steward Observatory
  Buell T. Jannuzi, Director
  Mark V. Buglewicz, Assistant Director, Business Services
Summary

Our audit of sales and services revenue was included in our approved Fiscal Year (FY) 2016 Audit Plan. The University of Arizona’s (UA) *Never Settle* plan encourages entrepreneurial activities and the development of new revenue sources, such as revenue generated from sales and services. While previous audits have included revenue recorded as sales and services, this is our first audit with a scope focused on these types of revenues across campus.

**Background:** UA receives revenue from a large variety of sources, including tuition, state appropriations, grants, investments, and sales of goods or services. While some revenue types are received centrally, such as tuition and state appropriations, other revenues are received directly by individual departments. These individual departments may identify a service or product that stems from their academic activities but that can be offered to the public for a fee.

Sales and services are recorded in a group of object codes in UA’s Financial Services Manual (FSM) and include the sales of goods, admissions, royalties, fines, and rentals. As allowed under Arizona Board of Regents Policy 1-105, the services and goods help fulfill the public service mission of UA and/or contribute to educational or research experiences for students. In addition, if the service or product is sold by a service center that also supports federal research, the pricing must not be less than the pricing offered to research projects.

When individual departments launch a revenue-generating activity, the department head is responsible for ensuring there are adequate controls in place to monitor the activity, receive the revenue, and deposit the funds with the Financial Services Office - Bursar’s Office in accordance with UA policy. These activities are typically delegated to department business managers, fiscal officers, or program coordinators.

**Audit Objective:** Our primary audit objective was to determine whether FY 2016 sales and services revenue complied with UA policies and procedures and good business practices.
**Scope:** The scope of this audit included revenues recorded in the sales and services group of object codes (object codes 0400 through 0690, excluding object codes categorized as investment income in the FSM) with the following exclusions:

- Auxiliary accounts were excluded, as these types of activities have been subject to separate audits during the last several fiscal years;
- Agency accounts were excluded, as these types of accounts are, by definition, not UA funds;
- Revenue recorded as Seminars and Conferences was excluded, as they were subject to a separate internal audit on the FY 2016 Audit Plan; and
- Internal Billings and Service Billings were excluded, as these are transactions between campus departments rather than with an external party.

The population analysis yielded approximately 230 departments that recorded approximately $90 million as sales and services revenue. From this population of sales and services activity, we judgmentally selected a sample of 8 departments with a variety of revenue-generating activities for detailed testwork, ensuring that a variety of activities and dollar amounts were included in the sample. The sampled departments and activities totaled approximately $25,965,000, or 29% of the total population.

The following summarizes the departments and activities selected for detailed testwork:

<table>
<thead>
<tr>
<th>Division/Department/Unit</th>
<th>Description of Activities Included in Audit Sample</th>
<th>Approximate FY 2016 Revenue Included in Audit Sample (in thousands of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>College of Medicine - Tucson</td>
<td>Contractually obligated support provided for College of Medicine activities by College partner organizations.</td>
<td>$14,712</td>
</tr>
<tr>
<td>Real Estate Administration</td>
<td>Facilities and space leases administered by REA.</td>
<td>$4,269</td>
</tr>
<tr>
<td>Steward Observatory</td>
<td>Revenue from services provided to other organizations that have astronomy equipment in the area, as well as educational programs and space rental.</td>
<td>$3,025</td>
</tr>
<tr>
<td>Trademarks and Licensing</td>
<td>Licensing fees for use of UA trademarks.</td>
<td>$1,801</td>
</tr>
<tr>
<td>School of Animal and Comparative Biomedical Sciences</td>
<td>Analysis work performed by two separate laboratories within the department.</td>
<td>$888</td>
</tr>
<tr>
<td>Arizona Research Labs</td>
<td>Analysis work performed by laboratories under the oversight of Arizona Research Labs.</td>
<td>$794</td>
</tr>
<tr>
<td>Aerospace and Mechanical Engineering</td>
<td>Revenue from an international student intern program and sales of an educational tool built in an AME lab and used by other engineering instructors.</td>
<td>$261</td>
</tr>
<tr>
<td>Continuing Medical Education Virtual Lecture Hall</td>
<td>Online and in-person continuing education courses offered to all medical professionals.</td>
<td>$215</td>
</tr>
</tbody>
</table>
In addition, initial planning work included contractually obligated support provided to the College of Medicine - Phoenix, totaling approximately $35 million. However, as testwork continued, we determined that this revenue was accurately reclassified as private grants and contracts, and therefore was excluded from further sales and services testwork.

**Methodology:** Our audit objective was accomplished by performing the following:

- Performing a preliminary risk assessment of fiscal year 2016 sales and services revenue and identifying departments, sales types, or other risk areas that would be selected for detailed testwork (as listed under Scope). The preliminary assessment also included identifying four departments and revenue types with unusually low revenue amounts and reviewing to ensure it was reasonable that there was revenue recorded and that the low revenue was not an error.

- For each sampled department, identified the contact person(s) and met to discuss the revenue process, including evaluating procedures for:
  
  - Receiving customer requests,
  
  - Recording sales,
  
  - Invoicing and billing,
  
  - Receiving cash, check, and/or credit card payment,
  
  - Depositing revenue,
  
  - Reconciling invoices to payment documentation (prepared receipts, logs, credit card receipts, etc.), and
  
  - Monitoring receivables.

- Conducted department follow-up meetings as needed to review additional documentation and procedures. In addition, where required, meetings included college-level business staff to gain a full understanding of procedures.

- Reviewing procedures over approximately $35 million in revenue to the College of Medicine - Phoenix, which was initially recorded as services revenue but then accurately adjusted to private grants and contracts revenue during year-end closeout.

- Reviewing compliance with applicable UA policies, including:
  
  - FSM 4.02 Revenue Object Code Definitions;
  
  - FSM 8.00 Cash and Non-cash Receipts;
  
  - FSM 18.00 Service Centers;
  
  - FSM 20.10 Unrelated Business Income Tax; and
  
  - Product Licensing and Trademark Usage (Policy UR-101).
Sales and Services Revenue

- Discussing selected procedures with the following UA administrative units and staff:
  - Chief Risk Officer;
  - Senior Director, Research Partnership Services, within the Office for Research, Discovery and Innovation (RDI);
  - Director, Contract and Research Support Program, within RDI;
  - Director, Export Control Program, within RDI;
  - Director, Institutional Relations, within the Office of Global Initiatives;
  - Accountant, Principal, Financial Management, within the Financial Services Office; and
  - Program Coordinator, Senior, Bursar’s Office within the Financial Services Office.

Conclusion: UA departments provide a wide range of services and product sales to further UA’s strategic mission and generate additional revenue. While revenue-generating departments are typically thought of as the larger auxiliary-type units, analysis during this audit identified more than $90 million in sales and services revenue transactions by approximately 230 non-auxiliary units. The units included in this audit do not generally have revenue-generation as their primary function, but have developed items and services that may be marketed to or are sought out by external customers.

We found that overall, the departments were able to implement internal controls over the revenue billing, receiving, depositing, and reconciling processes and were in compliance with UA policies and good business practices. Revenue processes are decentralized prior to deposit of funds, and we found that the departments were able to design procedures that fit their needs.

Because these units are not primarily revenue-generating units, there is a wide range of employee expertise related to tracking sales, invoicing, receiving payment, and reconciling sales and inventory. Some sampled units have worked with others to form small business offices that serve a number of departments, functions, or activities. For example, the Arizona Research Labs business office oversees all labs under the department umbrella and is able to ensure billing and payment functions are adequately segregated from service performance functions. In other cases, sales and services are overseen by academic department business officers, who must be familiar with all types of business transactions.
Sales and Services Revenue

It is critical to UA’s ability to continue to accept credit card payments that each unit have strong controls in place to comply with the Payment Card Industry Data Security Standards (PCI DSS), as are incorporated into FSM 8.14 Merchant (Bank Card/Credit Card) Acceptance Policy and Procedures. The testwork found that many of the departments do accept credit cards, and PCI standards are well-understood. The departments work closely with the Bursar’s Office to document PCI compliance; we did not identify any PCI-related concerns.

Sales and services revenue is allowable within any department, provided the department complies with UA policies. However, any sales or services that are generated from activities related to sponsored projects or that represent a longer-term commitment of UA facilities or expertise are expected to be approved by the Contract and Research Support Program, under RDI. However, there are no clear criteria or policies to identify what activities should go through RDI and what only need department-level approval. There is currently a committee working to clarify this issue, with the hopes of further guidance being available to departments in the future.

Finally, UA’s current lack of written authorized signer procedures impairs departments’ abilities to comply with UA policy. While these sales and services are not typically huge contracts, often there is a reason that a signed agreement is used. In other departments, it is common that employees negotiate with the customer or in other ways commit UA to perform something in the future, without actually signing a physical contract. Signing agreements and verbally committing UA to future obligations are both activities that should only be done by an authorized signer. Currently, there is no written listing of authorized signers and past authorized signers have not been notified whether or not their prior authorization is still valid. Central administrative units are working to implement a new procedure; however, no implementation date is available.

We identified certain isolated areas where departments could improve efficiencies and have provided these minor recommendations to department management.
According to the Institute of Internal Auditors International Professional Practices Framework, an organization is expected to establish and maintain effective risk management and control processes. These control processes are expected to ensure, among other things, that:

- The organization’s strategic objectives are achieved;
- Financial and operational information is reliable and possesses integrity;
- Operations are performed efficiently and achieve established objectives;
- Assets are safeguarded; and
- Actions and decisions of the organization are in compliance with laws, regulations, and contracts.

Our assessment of these control objectives as they relate to sampled sales and services revenue is presented below.

<table>
<thead>
<tr>
<th>General Control Objectives</th>
<th>Control Environment</th>
<th>Audit Result</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Achievement of the Organization’s Strategic Objectives</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Revenue-generating activity supports UA strategic mission.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td><strong>Reliability and Integrity of Financial and Operational Information</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Revenue is accurately recorded and monitored.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td><strong>Effectiveness and Efficiency of Operations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Procedures are adequate to ensure payment is received for all sales.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td><strong>Safeguarding of Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Inventory controls are adequate to ensure all inventory is either still on hand or accounted for via a documented sale.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td><strong>Compliance with Laws and Regulations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Revenue generating activities and associated cash receiving processes are in compliance with UA policies.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
<tr>
<td>• Contracts and other documents are signed by an authorized employee.</td>
<td>Reasonable to Strong Controls in Place</td>
<td></td>
</tr>
</tbody>
</table>

We appreciate the assistance of UA employees during this audit.

/s/ Amanda L. Perkins, CPA  
Auditor-In-Charge  
(520) 626-3726  
alperkin@email.arizona.edu

/s/ Sara J. Click, CPA  
Chief Auditor  
(520) 626-4155  
clicks@email.arizona.edu