April 18, 2014

Dr. Daniel,

We have completed an audit over Contracts as part of our fiscal year 2014 Audit Plan, and the report is attached for your review. The audit was conducted in accordance with the Institute of Internal Auditors’ International Standards for the Professional Practice of Internal Auditing. The objectives of the audit were to provide assurance that adequate controls exist over the management of high-risk contracts and to determine if UTD and the contractor were in compliance with the terms of the contract.

Overall, we found that internal controls can be strengthened and operational processes could be enhanced to ensure compliance with UT System policies and procedures, executed contracts have received proper review, and contracts were signed by an authorized employee as delegated by the President.

Management has reviewed the recommendations and has provided responses and anticipated implementation dates. Though management is responsible for implementing the course of action outlined in the response, we will follow up on the status of implementation subsequent to the anticipated implementation dates. We appreciate the courtesies and considerations extended to us during our engagement. Please let me know if you have any questions or comments regarding this audit.

Toni Stephens
Executive Director of Audit and Compliance

UT Dallas Responsible Parties:
Mr. Pete Bond, Assistant Vice President for Procurement Management

Members of the UT Dallas Audit and Compliance Committee:
Dr. Hobson Wildenthal, Executive Vice President and Provost
Dr. Calvin Jamison, Vice President for Administration
Mr. Terry Pankratz, Vice President for Budget and Finance
Dr. Andrew Blanchard, Vice President for Information Resources and Chief Information Officer
Dr. Bruce Gnade, Vice President for Research
Dr. Darrelene Rachavong, Vice President for Student Affairs
Mr. Timothy Shaw, University Attorney
Ms. Lisa Choate, Partner, Ultimate Health Resources

The University of Texas System:
Dr. Pedro Reyes, Executive Vice Chancellor for Academic Affairs
Alan Marks, Attorney
Mr. J. Michael Peppers, CIA, CRMA, CPA, FACHE, Chief Audit Executive
Ms. Moshmee Kalamkar, CPA, CIA, Audit Manager

State of Texas Agencies:
Legislative Budget Board
Governor’s Office
State Auditor’s Office
Sunset Advisory Commission
Executive Summary

Contracts, Report No. 1412

Audit Objective and Scope: To provide assurance that adequate controls exist over the management of high-risk contracts and to determine if UTD and the contractor were in compliance with the terms of the contract. The scope of the review was fiscal year 2013 to date.

Audit Results: The audit resulted in no recommendations considered significant to University operations; however, we offer the following recommendations to strengthen the financial reporting process.

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Estimated Implementation Date</th>
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</thead>
<tbody>
<tr>
<td>(1) Enhance Monitoring Procedures for Active Agreements.</td>
<td>April 30, 2014</td>
</tr>
<tr>
<td>(2) Centralize Maintenance of Existing Agreements</td>
<td>May 30, 2014</td>
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<tr>
<td>(3) Standardize Contract Reviews</td>
<td>March 31, 2014</td>
</tr>
<tr>
<td>(4) Establish Process to Identify High-Risk Contracts</td>
<td>March 31, 2014</td>
</tr>
</tbody>
</table>

Conclusion: Based on the audit work performed, we conclude that opportunities exist to improve internal controls over the area reviewed. Implementation of the recommendations will enhance internal controls and compliance with applicable policies and procedures.

Responsible Vice President: Mr. Terry Pankratz, Vice President for Budget and Finance

Responsible Parties: Mr. Pete Bond, Assistant Vice President for Procurement Management

Staff Assigned to Audit: Dylan Becker, CPA, CIA, Senior Auditor
# Table of Contents

Background ........................................................................................................................................ 4

Audit Objective ................................................................................................................................... 5

Scope and Methodology ....................................................................................................................... 5

Audit Results and Management’s Responses ...................................................................................... 6

Audit Recommendations

1. *Enhance Monitoring Procedures for Active Agreements* .............................................................. 6

2. *Centralize Maintenance of Existing Agreements* ........................................................................ 7

3. *Standardize Contract Reviews* .................................................................................................... 8

4. *Establish Process to Determine High-Risk Contracts* ............................................................... 9

Conclusion .......................................................................................................................................... 10
Background

Contracts at UT Dallas are maintained by three departments, with each department responsible for maintaining different types of agreements. Procurement Management has provided guidelines over contract processing, review procedures, and approval requirements. The contract guidelines provided by Procurement Management have been established at a separate site dedicated to providing guidance over contracts at UTD.\(^1\)

Administration is responsible for revenue generating contracts and lease agreements, the Office is Sponsored Projects is responsible for contracts with sponsors that award grants, including those for federally funded research, and Procurement Management is responsible for contracts with outside vendors that provide goods and services to UTD. Each of these three areas that are responsible for maintaining contracts have unique processes and methods to ensure contracts are properly maintained, executed according to UTD and UT System policies, and adequately monitored.

UT System has provided contract review procedures\(^2\) that include nine steps that each UT institution is required to complete to help determine if additional review by the Office of General Counsel at UT System is required. Further guidance has also been provided to help determine when contracts are considered a Special Procedure Contract\(^3\), or when thresholds for spend have been reached that may trigger automatic review by the Board of Regents. Each institution has been delegated autonomous authority to execute agreements up to a certain dollar amount, as determined by UT System. The thresholds for total spend for each UT institution is documented below:

<table>
<thead>
<tr>
<th>$250,000</th>
<th>$500,000</th>
<th>$1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>UT Brownsville</td>
<td>UT Arlington</td>
<td>UT Austin</td>
</tr>
<tr>
<td>UT Pan American</td>
<td>UT Dallas</td>
<td>UT Medical Branch Galveston</td>
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<td>UT Permian Basin</td>
<td>UT El Paso</td>
<td>UT HSC - Houston</td>
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<tr>
<td>UT HSC - Tyler</td>
<td>UT HSC - San Antonio</td>
<td>UT Southwestern Medical Center</td>
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<tr>
<td>UT Tyler</td>
<td>UT San Antonio</td>
<td></td>
</tr>
</tbody>
</table>

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1. [www.utdallas.edu/procurement/contracts](http://www.utdallas.edu/procurement/contracts)
2. [http://www.utsystem.edu/ogc/contracts/contractreview.htm](http://www.utsystem.edu/ogc/contracts/contractreview.htm)
3. [http://www.utsystem.edu/ogc/contracts/specialcontracts.htm](http://www.utsystem.edu/ogc/contracts/specialcontracts.htm)
The administration and review processes over contracts are guided by UT System requirements. Several policies and board rules help UT Institutions determine when additional review by the Office of General Counsel is required and when UT institutions may execute contracts without additional oversight. The Presidents of each UT Institution have authority to establish internal review and approval procedures for all contracts at their institutions and may delegate contract signing authority to other employees. In addition, there are certain types of contracts, such as those that deal with or relate to health and safety issues, contracts related to criminal background check services, revenue generating, revenue sharing, and cost avoidance contracts that may cause UT institutions to incur unrelated business income tax that mandate review by the Office of General Counsel regardless of anticipated spend.

Audit Objective

To provide assurance that adequate controls exist over the management of high-risk contracts and to determine if UTD and the contractor were in compliance with the terms of the contract.

Scope and Methodology

The scope of this audit was fiscal year 2013 to date, and our fieldwork concluded on February 6, 2014. To satisfy our objectives, we performed the following:

- Interviewed staff and observed documentation to gain an understanding of current operations and processes.

- Tested selected contracts to determine:
  - The accuracy of invoiced amounts compared to pricing schedule;
  - That the wages paid for services agreed to the schedules of work;
  - The executed agreement was signed by an authorized employee as delegated by the President;
  - A proper segregation of duties existed;
  - That the contract process complied with UTS 145.

- Reviewed selected accounting activities within service related accounts to ensure:
  - An active agreement existed, if needed;
  - Contract was signed by an authorized employee as delegated by the President;
  - The contract process complied with UTS 145.

4 https://www.utsystem.edu/bor/procedures/policy/policies/uts145.html
Where applicable, we conducted our examination in accordance with the guidelines set forth in The Institute of Internal Auditor’s *International Standards for the Professional Practice of Internal Auditing*. The Standards set criteria for internal audit departments in the areas of independence, professional proficiency, scope and performance or audit work, and management of the internal auditing department.

**Audit Results and Management’s Responses**

Overall, internal controls can be strengthened and operational processes could be enhanced to ensure compliance with UT System policies and procedures. Our audit work indicated that the following controls currently exist:

- Master Agreements were properly approved by a delegated employee authorized by the President.
- A proper segregation of duties existed during the contract review process.

A priority recommendation is defined as one that may be material to operations, financial reporting, or legal compliance. This would include an internal control weakness that does not reduce the risk of irregularities, illegal acts, errors, inefficiencies, waste, ineffectiveness, or conflicts of interest to a reasonable low level.

We have no priority recommendations resulting from this audit; however, the following recommendations will help enhance the financial reporting process and minimize the risk of material misstatements going undetected in a timely manner.

**Audit Recommendations**

**1**  Enhance Monitoring Procedures for Active Agreements

Active agreements with outside vendors that provide goods or services are managed and maintained by the departments. The departments are responsible for ensuring the invoiced amounts are accurate, the services performed agree to the schedules of work, and the contractor or vendor has complied with the terms and conditions of the agreement.
We reviewed 11 contracts and noted that three (27%) out of the 11 had errors with invoiced amounts that were unfavorable to UTD when compared to agreed-upon pricing in the master agreements. Two of the 11 agreements (18%) contained provisions within the pricing schedules for early payment discounts. For the two agreements reviewed, UTD would have realized an approximate return of 18% and 25% had the discount been taken. Additionally, we noted there was no process to identify and track when contracts were about to expire or when they were up for a renewal. Best practices suggest that continuous on-going monitoring of existing contracts helps ensure invoicing accuracy, early payment discounts are realized, and minimize the risk of expired agreements going undetected in a timely manner.

There were no established processes or guidance provided to departments to help monitor existing agreements and as a result, there is an enhanced risk that billing errors and expired agreements will not be detected in a timely manner.

**Recommendation:** Management should consider establishing a process to provide on-going monitoring of existing agreements with outside vendors.

**Management’s Response:** We concur and will establish a process to provide on-going monitoring of existing agreements with outside vendors.

**Estimated Date of Implementation:** April 30, 2014

**Person Responsible for Implementation:** Pete Bond, Assistant Vice President for Procurement Management, for Division of Budget & Finance

(2) **Centralize Maintenance of Existing Agreements**

Contract maintenance is a continuous process that allows organizations to ensure active agreements are properly stored, amendments or changes to pricing schedules are maintained with the master agreement, and contracts are readily accessible as needed. Additionally, contract maintenance helps determine how well the vendor or supplier performed, and ensures the requirements of the master agreement were met according to the terms and conditions.

There is no central repository for executed agreements at UTD. Additionally, we noted that amendments and pricing schedules were maintained separately from the master agreement and no reporting requirements existed to management to track and record vendor performance, billing errors, or delayed goods or services. Best practices suggest maintaining active agreements in a central location and establishing reporting requirements to track vendor performance enhances the visibility of existing contracts, ensures all related documents such as amendments and pricing schedules are appropriately tracked and accessible, and helps provide assurance that vendors who have consistently underperformed are appropriately considered prior to awarding a contract.
There were no defined methodologies to maintain active agreements and no formal reporting requirements observed, and as a result, there is an enhanced likelihood that vendors who have not met the requirements of the contract will go undetected and that active agreements or related documents to the master agreement will not be located in a timely manner.

**Recommendation:** Management should consider creating a central repository for all active agreements to ensure amendments and updated pricing schedules are maintained with the pricing agreement and existing agreements are properly monitored.

**Management’s Response:** We concur and will consider a contracts management software to serve as the central repository.

**Estimated Date of Implementation:** May 30, 2014

**Person Responsible for Implementation:** Pete Bond, Assistant Vice President for Procurement Management, for Division of Budget & Finance

(3) **Standardize Contract Reviews**

UT System has established criterion to help UT Institutions determine when a contract must be sent to the Office of General Counsel (OGC) for review. The Executive Vice Chancellor for Business Affairs and the Vice Chancellor and General Counsel established contract value thresholds for each UT Institution as part of the criterion to be used to determine when a review by OGC is required. UT System has also delegated contract signing authority to the presidents of each institution and granted authorization for the presidents to delegate contract signing authority to selected employees.

We reviewed 13 master agreements that were renewed by UTD after the original expiration date and noted that three (23%) appeared to have met the mandatory review criteria established by UT System but were not sent to OGC. Additionally, one agreement (8%) had an amended pricing agreement that was not authorized by an employee delegated contract signing authority by the President.

- UT System Board Rule, Section 3.1.2 states, “Any amendment, extension, or renewal that increases the cost or monetary value of the original contract to more than $1m must be submitted to the Board for approval or authorization. Any amendment, extension, or renewal with a cost or monetary value that exceeds 25% of the cost or monetary value of the original contract approved by the Board must be submitted to the Board for approval.”
- UT System Board Rule 10501 Section 1.3 states, “The primary delegate identified in these Rules and Regulations or in an official Board action may further delegate his or her delegated authority to a secondary delegate unless otherwise specified.” Dr. Daniel has delegated the authority to sign certain categories of contracts, on behalf of the President, to specific individuals named in the Delegations of Authority for the University of Texas at Dallas.

No standardized processes exist to review and amend existing contracts and inconsistent considerations were given for additional reviews by OGC. As a result, there is an enhanced risk that agreements may contain unfavorable terms and conditions to UTD, and that UTD is not compliance with UT System policies and procedures.

**Recommendation:** Management should consider implementing additional processes to ensure that contracts that met the threshold for additional review are sent to the Office of General Counsel.

**Management’s Response:** We concur and will implement additional processes as recommended.

**Estimated Date of Implementation:** March 31, 2014

**Person Responsible for Implementation:** Pete Bond, Assistant Vice President for Procurement Management, for Division of Budget & Finance

(4) **Establish Process to Determine High-Risk Contracts**

Contracts can vary in terms of duration, total spend, as well as the terms and conditions detailed in each agreement. The risks to UTD as a result of an executed agreement can vary greatly depending on the type of agreement and scope of goods or services provided.

During the review, we noted that there were no established protocols to determine which contracts should be considered high risk to UTD. All contracts were treated equally, and no additional internal reviews were completed over agreements that bind UTD for multiple years or may have a large or complex scope included in the terms and conditions. While UT System has established criterion to determine when agreements need further reviews, best practices suggest that high risk criterion established by an individual organization enhances monitoring activities, helps ensure vendor compliance, and reduces the risk of inaccurate or erroneous payments.

There were no established metrics or methods to determine which agreements should be considered high risk and as a result, all contracts were treated as having equal risks.

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5 [http://www.utdallas.edu/search/?s=main&q=delegations+of+authority](http://www.utdallas.edu/search/?s=main&q=delegations+of+authority)
to UTD regardless of the total estimated spend, duration of the agreement, or scope of the goods or services provided by the vendor.

**Recommendation:** Management should consider establishing criterion that would help determine which agreements should be considered high risk.

**Management’s Response:** We concur and will establish criterion for identifying high risk contracts and providing additional scrutiny to ensure risk is managed.

**Estimated Date of Implementation:** March 31, 2014

**Person Responsible for Implementation:** Pete Bond, Assistant Vice President for Procurement Management, for Division of Budget & Finance

**Conclusion**

Based on the audit work performed, we conclude that opportunities exist to improve internal controls over the management of high-risk contracts and ensure that UTD and the contractor were in compliance with the terms and conditions of the contract. Implementation of the recommendations will enhance internal controls and compliance with applicable policies and procedures.

We appreciate the courtesy and cooperation received from the management and staff of the Office of the Vice President for Budget and Finance and Administration during this audit.