November 3, 2017

S. Clay Johnston, M.D., Ph.D.,
Vice President for Medical Affairs and Dean of the Dell Medical School
The University of Texas at Austin Dell Medical School
1501 Red River Street
Austin, TX 78712

Dear Dr. Johnston:

The University of Texas (UT) System Audit Office has completed an audit of Dell Medical School’s use of Available University Funds (AUF) and Permanent University Funds (PUF) through the Science and Technology Acquisition and Retention (STARs) Program. The detailed report is attached for your review.

We conducted our audit in accordance with The Institute of Internal Auditors’ International Standards for the Professional Practice of Internal Auditing.

We will follow-up on recommendations made in this report to determine their implementation status. Any requests for extension to the implementation dates require approval from the System Administration Internal Audit Committee. This process will help to enhance accountability and ensure that audit recommendations are implemented in a timely manner.

We appreciate the assistance provided by management and other personnel from the Dell Medical School’s Finance Department. We hope the recommendations presented in our report are helpful.

Sincerely,

J. Michael Peppers, CPA, CIA, QIAL, CRMA
Chief Audit Executive

cc: Darrell Bazzell, Senior Vice President and Chief Financial Officer, UT Austin
Dr. C. Martin Harris, Chief Business Officer for the Dell Medical School, UT Austin
Dwain Morris, Chief Administrative Officer for the Dell Medical School, UT Austin
Susie Scheffler, Director of Finance for the Dell Medical School, UT Austin
Mike Vandervort, Chief Audit Executive, UT Austin
The University of Texas System Administration
An Audit of Dell Medical School’s Use of Available University Funds (AUF) and Permanent University Funds (PUF) through the Science and Technology Acquisition and Retention (STARs) Program
FY 2017

November 2017

THE UNIVERSITY OF TEXAS SYSTEM AUDIT OFFICE
210 WEST SIXTH STREET, SUITE B.140E
AUSTIN, TX  78701
(512) 499-4390
EXECUTIVE SUMMARY
Since May 2012, the University of Texas (UT) Board of Regents (BOR) has approved approximately $150 million of Available University Funds (AUF) and $40 million of Permanent University Funds (PUF) through the Science and Technology Acquisition and Retention (STARS) program for the creation and operation of a medical school at UT Austin. The Texas Constitution requires that AUF be appropriated for the payment of the principal and interest due on the bonds backed by the PUF and for the support and maintenance of UT Austin and UT System Administration. The STARS program is funded by PUF bond proceeds and program funds can only be used for laboratory renovation and equipment purchases as part of the recruitment or retention of particularly outstanding faculty.

The objective of this engagement was to determine whether funds approved by the BOR are being spent in support of the UT Austin Dell Medical School (DMS) and in accordance with applicable institutional and UT System requirements. The audit scope included expenditures made during the period from September 1, 2012 through May 31, 2017. During this period, the DMS spent approximately $46.4 million of AUF and $3.2 million of PUF through the STARS Program. We have been informed that future AUF expenditures will be largely limited to debt service payments for DMS facilities which are expected to total approximately $27 million per year.

We tested a combined sample of 60 AUF and PUF expenditure transactions totaling $3.9 million and determined that all expenditures tested were in support of the DMS. Based on a review of the DMS’s financial procedures and evaluation of selected internal controls, we also determined that DMS management has established an adequate control environment. Internal control strengths include compliance and ethics training, segregation of duties, providing financial education to staff, internal financial reporting, and account reconciliations. However, we also noted opportunities to strengthen controls over contract monitoring, procurement, and documentation of approvals; and to ensure PUF expenditures made for the STARS Program support the intended purpose.

To address these observations, we have recommended that management:
1) Develop and implement a risk-based contract monitoring process;
2) Ensure compliance with UT Austin procurement procedures;
3) Obtain all required expenditure approvals and establish consistent methods of documenting those approvals; and
4) Ensure that future STARS projects directly support the recruitment and retention of outstanding faculty.

CONCLUSION
Overall, the DMS has spent AUF and PUF to support of the medical school’s operations. In addition, DMS management has also established an adequate control environment. While there were no priority findings, opportunities exist to strengthen controls over contract monitoring, procurement, and documentation of approvals; and to ensure PUF expenditures made for the STARS Program support the intended purpose.

Management agreed with the observations and recommendations and has reported that it will take actions to address each recommendation by the end of December 2017. We appreciate the support and assistance provided by the DMS throughout this audit.

J. Michael Peppers, CPA, CIA, QIAL, CRMA
Chief Audit Executive

Eric J. Polonski, CPA, CIA
Audit Director
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We tested a combined sample of 60 AUF and PUF expenditure transactions totaling $3.9 million and determined that all expenditures tested were in support of the DMS. Based on a review of the DMS’s financial procedures and evaluation of selected internal controls, we also determined that DMS management has established an adequate control environment. Internal control strengths include compliance and ethics training, segregation of duties, providing financial education to staff, internal financial reporting, and account reconciliations. However, we also noted opportunities to strengthen controls over contract monitoring, procurement, and documentation of approvals; and to ensure PUF expenditures made for the STARs program support the intended purpose.

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CONCLUSION
Overall, the DMS has spent AUF and PUF to support of the medical school’s operations. In addition, DMS management has also established an adequate control environment. While there were no priority findings, opportunities exist to strengthen controls over contract monitoring, procurement, and documentation of approvals; and to ensure PUF expenditures made for the STARs program support the intended purpose.

Management agreed with the observations and recommendations and has reported that it will take actions to address each recommendation by the end of December 2017. We appreciate the support and assistance provided by the DMS throughout this audit.

J. Michael Peppers, CPA, CIA, QIAL, CRMA
Chief Audit Executive

Eric J. Polonski, CPA, CIA
Audit Director
BACKGROUND
In May 2012, the BOR approved an allocation of AUF for the creation and operation of a medical school at UT Austin. The amount of the allocation would be $25 million per year or a 3% increase in UT Austin’s annual AUF distribution, whichever is greater. The BOR has continued to support operation of the medical school by allocating an additional $40 million of AUF in December 2016 for a neurosciences and brain health initiative. As illustrated in the table below, UT Austin has been provided nearly $150 million of AUF in support of the DMS.

The Texas Constitution, Article 7, Section 18, requires that the AUF be appropriated for the payment of the principal and interest due on the bonds backed by the PUF and for the support and maintenance of UT Austin and UT System Administration.

<table>
<thead>
<tr>
<th>Available University Funds</th>
<th>Fiscal Year (amounts are rounded to the nearest thousand)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Beginning Balance</td>
<td>$ 0</td>
</tr>
<tr>
<td>Allocated AUF</td>
<td>8,000,000</td>
</tr>
<tr>
<td>Expenditures²</td>
<td>1,739,000</td>
</tr>
<tr>
<td>Debt Service</td>
<td>0</td>
</tr>
<tr>
<td>Ending Balance</td>
<td>6,261,000</td>
</tr>
</tbody>
</table>

In addition to AUF, the BOR committed $40 million of PUF ($5 million per year for eight years) through the STARs program. Since the STARs program is funded by PUF bond proceeds, expenditures are subject to statutory requirements. The PUF bond proceeds can only be used for laboratory renovation and equipment purchases as part of the recruitment or retention of outstanding faculty in UT academic and health science institutions. Items purchased must have a useful life of more than one year and salaries cannot be paid from PUF bond proceeds.

<table>
<thead>
<tr>
<th>Permanent University Funds (STARs)</th>
<th>Fiscal Year (amounts are rounded to the nearest thousand)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2015</td>
</tr>
<tr>
<td>Beginning Balance</td>
<td>$ 0</td>
</tr>
<tr>
<td>Awarded Allocations³</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Expenditures²</td>
<td>356,000</td>
</tr>
<tr>
<td>Ending Balance</td>
<td>844,000</td>
</tr>
</tbody>
</table>

Construction of UT Austin’s DMS began in April 2014, allowing the medical school to welcome its first class of 50 students in June 2016. As illustrated in the tables above, $103.5 million in allocated AUF is available to be spent to support the DMS and $4.2 million of PUF for approved STARs projects are available for faculty recruitment as of May 31, 2017. These available amounts exclude future allocations of AUF and PUF to be provided to the DMS.

ENGAGEMENT OBJECTIVES
The objective of this engagement was to determine whether funds approved by the BOR in support of the DMS, including AUF and PUF through the STARs program, are being spent in support of the DMS and in accordance with applicable institutional and UT System requirements.

¹ FY 2017 amounts are through May 31, 2017.
² Includes net transfers and encumbrances as of May 31, 2017.
³ Awarded allocations are made from the $40 million pre-authorized by the BOR.
SCOPE & METHODOLOGY
The audit scope included expenditures during the period from September 1, 2012 through May 31, 2017. To achieve our objective, we reviewed DMS's internal policies and procedures; conducted interviews and walkthroughs with the DMS finance department staff to gain an understanding of related processes; and tested a sample of transactions to determine whether expenditures were in support of the medical school, properly approved, adequately supported, and accurately recorded.

We conducted our audit in accordance with the guidelines set forth in the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.

ENGAGEMENT RESULTS
During the period from September 1, 2012 through May 31, 2017, the DMS spent approximately $46.4 million of AUF and $3.2 million of PUF through the STARs Program. As illustrated in the chart to the right, the largest expenditure category was debt service payments for DMS facilities followed by contracted services, and construction and renovation. We have been informed that future AUF expenditures will be largely limited to debt service payments for DMS facilities which are expected to total approximately $27 million per year.

We tested a combined sample of 60 AUF and PUF expenditure transactions totaling $3.9 million. All of these expenditures were in support of the DMS and were adequately supported.

Additionally, we reviewed DMS's financial procedures and selected seven internal controls for evaluation. The selected controls were:

1) Compliance and ethics training,
2) Segregation of duties,
3) Review and approval of purchases,
4) Financial education provided to DMS employees,
5) Internal financial reporting,
6) Contract monitoring, and
7) Account reconciliations.

While the selected controls were in place and adequately designed, not all were in place for the entire audit scope because most of the DMS finance department staff were not hired until fiscal year (FY) 2015, and UT Austin eliminated its Central Business Office (CBO) at the end of FY 2016. Prior to FY 2017, the CBO was primarily
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responsible for processing DMS transactions. The DMS finance department, which is comprised of one director and three staff members, has since taken ownership of documenting, improving, and enforcing its financial policies and procedures with support from UT Austin central accounting.

Overall, the DMS has established an adequate control environment. Internal control strengths include compliance and ethics training, segregation of duties, providing financial education to staff, internal financial reporting, and account reconciliations. While there were no priority findings4, we noted opportunities for the DMS to strengthen certain internal processes.

**Contract Monitoring** - UT Austin has a centralized process for entering into contracts with external entities. Once contracts are established, UT Austin relies on individual departments to monitor their respective contracts. At the DMS, management in the finance and legal affairs departments work together to address any contract-related issues that arise. They also meet regularly with UT Austin procurement personnel to discuss contracting issues. However, neither UT Austin nor the DMS have an established post-contract execution monitoring process. In addition, the DMS staff has experienced difficulty in identifying a complete population of contracts to monitor because contract numbers are not always entered into the Departmental Financial Information Network (*DEFINE) accounting system in a consistent manner.

Texas Education Code section 51.9337(b)(3), which became effective September 1, 2015, requires that the board of regents of an institution of higher education establish a contract management handbook that provides consistent contracting policies and practices and contract review procedures, including a risk analysis procedure. UT Austin has not yet finalized a contract management handbook as required by statute. We were informed that a contract management handbook is awaiting approval by UT Austin’s Legal Affairs and may be published in Fall 2017.

The observation described above is considered a **medium-level** finding in accordance with UT System's Internal Audit finding classification system.

**Recommendation:** After UT Austin publishes its contract management handbook and establishes a risk analysis procedure, the DMS finance department should develop and implement a risk-based contract monitoring process.

**Management’s Response:** DMS finance and legal departments have started to develop and implement a risk-based contract monitoring process in partnership with UT Austin that is compliant with the finalized contract management handbook. DMS has hired a dedicated contract manager and is seeking to purchase and implement a contract management system by the end of 2017 to assist with the post-contract execution process.

**Anticipated Implementation Date:** End of the calendar year (December 31, 2017)

**Procurement Process** – During testing of AUF and PUF expenditures, we identified four instances in which DMS did not follow established contracting procedures. This included work performed prior to contract execution and purchasing security services when procurement of such services should have been coordinated

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4 A Priority Finding is defined as “an issue identified by an internal audit that, if not addressed timely, could directly impact achievement of a strategic or important operational objective of a UT institution or the UT System as a whole.” Non-Priority Findings are ranked as High, Medium, or Low, with the level of significance based on an assessment of applicable Qualitative, Operational Control, and Quantitative risk factors and probability of a negative outcome occurring if the risk is not adequately mitigated.
through UT Austin’s central procurement function. These instances occurred between June 2015 and May 2017. In all cases, the DMS finance department staff acted to ensure continuity of operations unique to the medical school and was not aware that certain procedures were not followed until notified by personnel from UT Austin central purchasing.

The observation described above is considered a medium-level finding in accordance with UT System's Internal Audit finding classification system.

**Recommendation:** DMS management should ensure that its procurement activities comply with UT Austin procurement procedures and coordinate with appropriate departments when available services are not suitable to meet the needs of the medical school.

**Management's Response:** In the spring and summer of 2017, DMS management instituted additional controls and processes to coordinate purchasing and contracting with UT Austin Procurement and Payment Services. DMS management will continue to partner with UT Austin Procurement and Payment Services to ensure compliance with UT Austin procurement procedures.

**Anticipated Implementation Date:** End of the calendar year (December 31, 2017)

**Documentation of Approvals** – In FY 2017, the DMS finance department staff developed and implemented an approval matrix for internal use within the DMS. Because the approval matrix was not in effect for the duration of our audit scope, we used auditor judgment to determine sufficiency of approvals obtained for applicable expenditures in our sample.

Approvals were documented in a variety of ways, ranging from formal written signatures and electronic approvals to e-mails and electronic routing comments. While inconsistent, we accepted any format of documented approval provided to us. However, for 23 expenditures tested (38%), there was insufficient documentation to demonstrate that appropriate levels of approval by DMS management were obtained. These expenditures occurred between October 2013 and March 2017. For 15 expenditures, the DMS obtained verbal approvals which were not documented. For the remaining expenditures, the purchases were not routed through DMS management for review or approval although similar purchases occurring during the same time period did have documented approvals. As illustrated in the table below, the percentage of transactions in our sample without documented approvals appears to have improved since the DMS implemented its approval matrix in fiscal year 2017. The overall volume of DMS’s transaction activity has steadily increased since construction of DMS facilities began in April 2014 and increased significantly after the DMS welcomed its first students in June 2016. The percentages shown in the table should be considered in light of the DMS’s significant growth.

<table>
<thead>
<tr>
<th>Description</th>
<th>FY14</th>
<th>FY15</th>
<th>FY16</th>
<th>FY17</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenditures without Documented Approval</td>
<td>1</td>
<td>4</td>
<td>12</td>
<td>6</td>
<td>23</td>
</tr>
<tr>
<td>Expenditures Tested</td>
<td>4</td>
<td>8</td>
<td>27</td>
<td>21</td>
<td>60</td>
</tr>
<tr>
<td>% of Transactions without Documented Approval</td>
<td>25%</td>
<td>50%</td>
<td>44%</td>
<td>29%</td>
<td>38%</td>
</tr>
</tbody>
</table>

The observation described above is considered a medium-level finding in accordance with UT System’s Internal Audit finding classification system.
Recommendation: DMS management should obtain all approvals required by the DMS Approval Matrix and establish consistent methods of documenting those approvals.

Management’s Response: All DMS expenditures are processed through the internal control environment of UT Austin. In the spring and summer of 2017, DMS management developed an internal documentation of approvals matrix to enhance the internal control environment within DMS. DMS management will ensure that appropriate approvals and documentation are obtained according to the internal DMS approval matrix. However, it should be noted that certain transfers to other UT Austin departments or schools for goods and services may occur within the UT Austin accounting system without prior written approval from DMS management for the specific transaction.

Anticipated Implementation Date: End of the calendar year (December 31, 2017)

The STARs Program—The STARs program is funded by PUF bond proceeds and subject to statutory requirements that limit expenditures. PUF bond proceeds provided in support of the STARs program can only be used for laboratory renovation and equipment purchases as part of the recruitment or retention of particularly outstanding faculty in UT academic and health science institutions. Items purchased must have a useful life of more than one year and salaries cannot be paid from PUF.

In May 2012, the BOR committed $40 million of “STARs recruiting monies” to UT Austin as “additional support to create the medical school.” UT Austin submitted capital projects for approval in accordance with UT System’s PUF expenditure guidelines applicable to Library, Equipment, Repair and Rehabilitation (LERR) funds. While these projects were in support of the medical school, they were not directly tied to the recruitment or retention of specific faculty members as traditionally required by the STARs program. In addition, it appears, from expenditures tested, that PUF spending requirements were met. UT System officials believed that UT Austin had significant flexibility in use of the available PUF funds from the STARs allocation to support the medical school. Consequently, UT System approved these projects and reimbursed UT Austin for associated project expenditures.

It is likely that the STARs projects submitted by UT Austin would have been eligible for PUF through the LERR program. As of May 31, 2017, UT System has approved $7,405,000 in awards from the $40 million in STARs funding committed by the BOR, and the DMS had spent less than half of the awarded amount.

The observation described above is considered a low-level finding in accordance with UT System’s Internal Audit finding classification system.

Recommendation: Consistent with the stated purpose of the STARs program, DMS management should ensure that future STARs projects submitted to UT System directly support the recruitment and retention of outstanding faculty.

Management’s Response: DMS management will continue to work with UT Austin and UT System to ensure that STARs funding is spent according to all applicable policies and guidelines.

Anticipated Implementation Date: End of the calendar year (December 31, 2017)