

An Audit Report on

Management Controls at Texas A&M University and the System Offices



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Key Points Of Report

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Key Findings

- Management's override of policies and procedures, laws, and channels of communication have eroded the effectiveness of control systems designed to protect resources from misuse and safeguard assets. This breakdown in controls has contributed to poor decision making, ineffective use of resources, weak oversight of operations, and a general lack of accountability. The results have been increased costs of operations, unlawful activities by some members of executive management, increased risks and liabilities associated with System and University operations, and negative publicity.
- The development of the cogeneration project was impaired by mismanagement. This project was to be the largest capital project in the University's history (estimated cost of \$75 to \$120 million). Management's override of controls increased the risks to the System and University that the cogeneration project would fail. The project was terminated, prior to completion, in June 1994.
- The University has not managed its risks and liabilities associated with contracting for services. Consultant services for almost \$1 million were rendered without a contract in place. A contract for more than \$300,000 has exceeded its dollar limit by more than double, without the appropriate approval of management.
- Not all departments are following University policies and procedures relating to human resources management. The Human Resources Department does not have monitoring processes to determine departmental compliance with applicable policies and procedures. In fiscal year 1994, the University expended nearly \$261 million in salaries, wages and benefits for its 7,500 employees.
- Duplication of data entry into the various automated administrative systems creates inefficiencies for the University. If departments were able to eliminate processing duplicate transactions, the University could redirect approximately \$1 million each year to more productive uses.

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This management control audit was conducted in accordance with Government Code, Section 321.0133.

Table of Contents

Executive Summary	1
Section 1:	
More Effective Leadership Is Needed To Manage The System and University	5
The Development Of The Cogeneration Project Was Impaired By Mismanagement	6
An Effective Contract Administration Process Is Needed To Manage The University's Risks and Liabilities Relating to Contracting	10
Observe Policies And Procedures Relating To Sponsored Research	15
Improved Compliance With Administrative Policies and Procedures Is Necessary To Assist Management In The Effective and Efficient Use Of Resources	19
Section 2:	
Improvements In Human Resources Management Are Needed For Hiring, Training, And Evaluating Personnel	26
All Hiring Of Non-Faculty Positions Should Be Coordinated By The University's Human Resources Department	27
Improvements In Monitoring And Documenting The Training Received By Personnel Are Needed To Gauge Their Level Of Development	29
Personnel Actions Need To Be Supported By Objective Employee Performance Evaluations	29
Improvements In Leadership Of The Power Plant Are Needed To Raise Employee Morale And Comply With University Policies	31

Table of Contents, concluded

Section 3:

**The University Needs To Efficiently Coordinate
Information Resources** 36

User Representation In The Design Phase Of Automated
Systems Would Minimize The Costly And Inefficient Need For
Duplication of Systems And Data Entry 37

The University Needs to Follow Policies for Automated System
Development, Maintenance, and Control 39

Appendices:

1 - Objective, Scope, And Methodology 42
2 - Department Profile 46
3 - A Detailed Review Of The Cogeneration Project 48

Executive Summary

Texas A&M University administration relies heavily on individuals, rather than on management systems, to provide assurances that resources are used efficiently and effectively and assets are safeguarded. This has created autonomous departmental administrative environments within the University, with differing levels of compliance with University administrative control systems.

The University has a fairly well-defined set of administrative policies and procedures designed to guide operations. However, they are not consistently followed by the departments, and University management does not consistently support their use.

Much of the responsibility for administrative operations (personnel, purchasing, contracting, etc.) has been delegated to the departments, but management has not held them accountable for these operations. This has resulted in the departments deciding which administrative policies and procedures they choose to follow.

Relying primarily on individuals is risky because they come and go, whereas systems of management control transcend changes in personnel. These systems of controls, when used as intended, can give continuity and consistency to a changing leadership scene. Since 1990, the Texas A&M University System (System) has had four chancellors, while Texas A&M University (TAMU) has had three presidents, both acting and appointed.

The issues in this report focus on areas where opportunities exist for management to improve and enhance University administrative controls.

More Effective Leadership Is Needed To Manage The System and University

Management's override of policies and procedures, laws, and channels of communication have eroded the effectiveness of control systems designed to protect resources from misuse and safeguard assets. This breakdown in controls has contributed to poor decision making, ineffective use of resources, weak oversight of operations, and a general lack of accountability. The results have been increased costs of operations, unlawful activities by some members of executive management, increased risks and liabilities associated with the System and University operations, and negative publicity.

The cogeneration project (estimated cost of \$75 - \$120 million) is one example of a breakdown in management controls. Management indicated this project was "a departure from business as usual" in that existing controls and processes were not followed. Currently, there is dispute between the University and the contractor regarding the costs incurred on the project.

An effective contract administration process is needed to manage the University's risk and liability. There are few policies regarding contracting, and the ones that are in place are not being consistently followed. An example was noted where consultant services for almost \$1 million were rendered without a contract in place. Contracts for hundreds of thousands of dollars are being entered into by departments without management's expressed approval or a legal review from the General Counsel. We noted a contract for more than \$300,000 that has exceeded its dollar limit, by more than double, without appropriate approval of management. Consulting services in excess of \$10,000 have been contracted for

Executive Summary

without using competitive bidding, as required by state statute, and legal services have been obtained without the required prior approval of the Attorney General.

The System and the University have policies and procedures addressing a number of aspects of their operations. However, while responsibility for many activities and related decisions has been delegated downward, it appears that an adequate mechanism has yet to be put in place to ensure that all areas of the University comply with the statutes, policies and procedures, contracts, account restrictions, and generally accepted practices governing their operations.

Improvements In Human Resources Management Are Needed For Hiring, Training, And Evaluating Personnel

Departments are allowed to do their own hiring, including walk-in applicants who have not been screened first by the Human Resource Department. This increases the risk that unqualified applicants will be hired, and that University Equal Employment Opportunity goals will not be realized.

Accurate records of training received by employees are not maintained by all the departments. This makes it difficult to monitor employee development with identified performance needs.

Personnel actions are taken without current evaluations which provide specific documentation to support those actions (promotions and merit increases).

In fiscal year 1994, the University expended nearly \$261 million in salaries, wages, and benefits for its 7,500 employees. These expenditures represented 49 percent of the

University's current funds expenditures for the year.

The University Needs To Efficiently Coordinate Information Resources

By having duplicate departmental administrative systems and a multitude of incompatible computer resources throughout the University, automated resources have not been used efficiently or effectively. Duplication of data entry into the various systems costs the University resources. If departments were able to eliminate processing duplicate transactions, the University could redirect approximately \$1 million each year to more productive uses.

An environment with a high degree of end-user computing is an indication that the central systems are not meeting the users' needs. The central automated financial system has been successful in enabling the University to gather financial information. However, it does not provide useful information at the departmental level. Therefore, the departments maintain their own stand-alone financial systems on personal computers.

Summary Of Management's Responses

Executive management of Texas A&M University and Texas A&M University System have emphasized their "commitment to implementing the recommendations of the audit report to the fullest." Management's responses address each recommendation by stating what initiatives have been implemented to date and those that are planned for implementation in the near future. Some responses regarding future action include time frames complete with schedules and dates for implementation.

Executive Summary

The System Chancellor and the University President, who both took office during this audit, have replied in their written response: "Please be assured that we will provide the leadership needed to ensure that the appropriate management controls, policies and procedures are established and followed, and that Texas A&M officials and staff at all levels are held accountable for their actions."

Summary Of Audit Objective And Scope

Our audit objective was to evaluate the existing management control systems within Texas A&M University and the Texas A&M

University System Administrative and General Offices to identify strengths and opportunities for improvement.

The scope of this audit included consideration of management's oversight, the use of public funds, contracting procedures, human resource management, and information resources management.

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Section 1:

More Effective Leadership Is Needed To Manage The System and University

Management's override of policies and procedures, channels of communication, and laws have eroded the effectiveness of control systems designed to protect resources from misuse and safeguard assets. This breakdown in controls has contributed to poor decision making, ineffective use of resources, weak oversight of operations, and a general lack of accountability. The results have been increased costs of operations, unlawful activities by some members of executive management, increased risks and liabilities associated with the System and University operations, and negative publicity.

Positive Initiatives By New Leadership Team

In the past, the leadership of the System and University has not always set a good example for others to follow. However, during our work, we noted areas where the new leadership team has taken initiatives to put control systems into place to help create an environment and its culture to better allow the University to achieve its mission. We commend these efforts and provide recommendations to assist in this process.

In most cases, the lack of well functioning management control systems has resulted in System and University leaders having to react to problems and situations as they occur. An effective system of management controls would provide an environment where leaders could be proactive in creating a culture that promotes accountability to the students, faculty, and staff of the System and University, the Legislature, and the citizens of Texas.

Following are examples of the types of problems identified in our audit, as well as some recent initiatives to improve the systems of controls. The purpose of these examples is to illustrate the impact of not having effective systems of management controls to guide operations.

Section 1-A:

The Development Of The Cogeneration Project Was Impaired By Mismanagement

A New Cogeneration Plant

The University began its efforts to have a new cogeneration plant in June 1992. The plant was to have been built on its growing West Campus to meet long-term energy needs through the year 2012. As initially proposed, an outside, third-party power producer would finance, design, construct, operate, and maintain the new plant on University land.

From the beginning, the cogeneration project, which was to be the largest capital project in the University's history (estimated cost of \$75 to \$120 million), was managed differently than other major construction projects. Management's override of existing channels of communication and policies and procedures removed the controls necessary to plan, organize, and monitor a project this large and complex. This override of controls increased the risks to the System and University that the cogeneration project would fail. The project was terminated, prior to completion, in June 1994.

The Board's oversight of the project appears to have been minimal. The project was never incorporated into the University's capital plan, and the Board's Facilities Planning and Construction Committee provided no oversight for the project. When the Board's involvement and support were solicited, the information received in briefings was limited and, at times, inaccurate.

Management of The Cogeneration Project Was a "Departure From Business As Usual"

The term "departure from business as usual" was used by TAMU officials managing the University's cogeneration project to describe and justify their actions. It appears to also have been a euphemism for the circumvention of normal channels, policies, and procedures in the name of expediency. From the beginning, the project was handled by a small group, including the former Board Chairman, the former Vice President for Finance and Administration, and the former Director of the Physical Plant. Neither the Board as a whole, the Chancellor, the President, nor various System functions were adequately involved in the decision-making process. We were told by one former System official that the project had been run by the former Board Chairman and the former Vice President for Finance and Administration and that they had been disinclined to share their information with others.

Neither the former President nor the former Chancellor were adequately involved in the decision-making process. Major project activities were handled by the former Board Chairman and the former Vice President for Finance and Administration at Texas A&M University (TAMU). Their alliance effectively circumvented established lines of authority, control processes, and the System's legal, financial, and technical functions. The following examples illustrate this point:

- In a memo dated May 10, 1993, the former Chancellor, who had an engineering background, raised concerns regarding the proposed plant which were never answered to his satisfaction. He stated that he found it hard to believe that long-term energy demand would grow at the projected rate for the new plant given an enrollment cap, the limited physical plant growth needed to handle that level of enrollment, and a likely increase in the costs of energy, creating strong incentives for conservation. He also expressed concern that the University be protected from being required to purchase more energy than it could use.

In response, the former Director of the Physical Plant, in a memo dated June 29, 1993, to the former Vice President for Finance and Administration, cited a contemplated excess power sales agreement (which was never completed or executed) as the mechanism for adjusting for variances in energy needs, further stating that "no one can accurately predict future energy needs."

- The System's Office of Facilities Planning and Construction, which could have provided significant management experience to the project, was bypassed. The Office of General Counsel was not consulted with respect to all contracts relating to the project. The System's financial staff and outside advisors were left out of the process, with different advisors being retained specifically for the project.
- In contrast, the former Board Chairman was personally involved in conversations or activities concerning the project as early as June 1992 and continued to be involved on an ongoing basis. His advice was sought in the hiring of consultants for the project, and one law firm was contracted through the consulting company after the former Board Chairman brought the firm to management's attention. A key meeting on the project was held in February 1993 in the Dallas office of the former Board Chairman's law firm, in which the former Vice President for Finance and Administration and the former

Director of the Physical Plant believed they were given sufficient authority to proceed. However, this was not a meeting of the Board. A regent can only act in his or her official decision-making capacity when a quorum of the Board is present in an official meeting. The former Board Chairman was also called upon to intercede when negotiations with the developer reached an impasse, and activities related to the project were postponed at times to accommodate his schedule.

The System did not manage the design and construction of this project as they normally would for a large construction project. Management of the project was conducted by a small team through the University Physical Plant Department. The project was to be built by a third-party developer, which was a process never before used by the System or University. Based on our review of the communication and technical problems, it appears that the cogeneration project team did not have the necessary qualifications to manage a project of this magnitude.

Throughout the project, correspondence among various parties reflected a sense of urgency and the need to expedite matters as quickly as possible to meet a final deadline of August 1, 1995. This compressed schedule likely contributed to a number of questionable decisions.

There is no record of any formal board action relating to the project until September 17, 1993, when the Board authorized the University President to execute a development agreement with the contractor to have the plant built. By this time, activities relating to the project had been underway for over a year: consultants had been hired, two Requests for Proposals had been issued, responses had been received and evaluated, and negotiations had been conducted with finalists for three and one-half months.

In September 1993, the University entered into a development agreement with a contractor to construct the new cogeneration power plant. Construction was to be in two phases: Phase I of the project was to provide chilled and hot water; Phase II covered all other areas, including building the power plant. Phase I construction started on campus in January 1994. The project, which was to be the largest capital project in the University's history, was begun even though management had not determined with certainty:

- how much the plant would cost (estimates of the project's cost ranged from an initial figure of \$75 million to as much as \$120 million)
- how it would be financed
- what the University's true energy needs were
- how they would dispose of any excess generated power (an issue directly affecting the ability to secure tax-exempt financing)

All of these unknowns are basic to an informed decision regarding the desirability and feasibility of building such a facility.

In January 1994, the Board authorized the Interim President to sign the various agreements which would document and finalize the proposed cogeneration project. In February, the Board designated three individuals as interim directors for the nonprofit corporation which would own the plant. Various individual members of the Board and executive management, however, began asking questions about the economic viability of the project, and satisfactory answers to their questions were not found. At this time, the System and the University had new individuals in leadership positions who did not have familiarity with the cogeneration project.

In an effort to obtain objective information on the project, a review was conducted by an outside firm at the request of the System Vice Chancellor for Finance and Operations. Their final report was issued on June 13, 1994. The report found numerous faults with the evaluation process and recommended that management discontinue its ongoing negotiations with the developer and reconsider its options. Phase II of the project (construction of the cogeneration plant) was terminated on June 17, 1994, by the newly hired President. On July 22, the Board confirmed the action to terminate Phase II of the development agreement.

At the time the project was terminated, a bond issuer had yet to be found. The outside firm's report indicated that the inability to secure a bond issuer was contributing to the virtual stoppage of the project at that time. Correspondence between the developer and the University in February 1994 discussed the difficulty inherent in securing a bond issuer given the lack of local support for the project as it was being conducted. Additionally, there was no guarantee that sufficient funding would be forthcoming from the Legislature. In fact, in fiscal year 1994, the University's utility appropriations failed to fully fund its energy expenditures.

As of the date the project was terminated, the developer claimed to have incurred approximately \$59 million in project-related costs. The development agreement appears to have capped the University's liability at \$15 million for Phase I. The System is currently involved in a dispute with the developer over the project costs, as well as a dispute over nearly \$1 million in unpaid billings from the primary consultant used by the University throughout the process.

Recommendation:

The Board of Regents should clearly define its own roles and responsibilities, along with the roles and responsibilities of System officers and University management. This will assist in delineating the appropriate roles and responsibilities associated with University governance.

The Board and management should observe established lines of authority and communication and ensure that executive officers and appropriate System functions are involved in the decision process for major University projects. Decisions involving major financial commitments should receive thorough analysis and deliberation.

Management should not initiate major capital projects in the absence of express authorization by the full Board. The Board, and its Facilities Planning and Construction Committee, should take an active oversight role for major capital projects. Management should be held accountable for providing sufficient and accurate information to enable the Board to fulfill its oversight responsibilities.

Management's Response:

The Board of Regents recently established a System Policies Committee of the Board. The Committee is responsible for reviewing existing policies, recommending revisions, additions or deletions and submitting recommended policies to the Board for implementation.

The policies will include, but are not limited to, administration, organization and governance, academic and research programs, finance, operations, human resources, real estate, facilities planning and construction, and public affairs.

Effective October 1, 1994, all agenda items regarding programs or projects with a budgetary impact over \$500,000 or a term longer than one year are required to include a fiscal analysis reviewed by the Vice Chancellor for Finance and Operations, before being submitted to the Chancellor and/or the Board of Regents.

All new capital projects in excess of \$300,000 require review by the Facilities Planning and Construction Department, the Vice Chancellor for Finance and Operations, the Chancellor, the Facilities Planning and Building Committee of the Board and the Board of Regents before initiation.

Section 1-B:

An Effective Contract Administration Process Is Needed To Manage The University's Risks and Liabilities Relating to Contracting

The System and University do not have a process in place to effectively manage the planning, acquisition, monitoring, and evaluation of their contracting for services. This has contributed to problems with the approval, performance, and payment of service contracts. These problems have increased the costs, risks, and liabilities associated with these contracts.

In the absence of an effective contract administration process, contracts have been entered into without the necessary approval and with no legal review to protect the University's interests. The contracts were inconsistently prepared and, in some cases, services were performed and billed with no contract in place.

It appears that state laws requiring bidding of consultant contracts and obtaining Attorney General approval for hiring outside legal counsel were not followed. A University official has recently been found guilty of soliciting gifts from a vendor.

There are indications that preferential treatment may have been given to some vendors during the negotiation and evaluation of proposals.

A discussion of several contracts reviewed during the audit provide examples of the problems discussed above.

The Consultants Used On The Cogeneration Project Were Inappropriately Hired And Billed The University For \$1 Million of Services Without An Authorized Contract In Place. In October 1992, the University entered into a relationship for consulting services, originally estimating that these services would cost \$250,000; ultimately, the company billed in excess of \$2 million. The company served as the primary consultants to the University on its proposed cogeneration project. The consultants were not hired in compliance with state statute and System policy requiring bidding of consulting services in excess of \$10,000. A significant amount of the billings, approximately \$1 million, was for work performed without a current contract authorizing the work.

The company was recommended by an outside attorney who performed legal work associated with the University's spot acquisitions of natural gas. The attorney shortly thereafter became a principal member of the project team as a senior representative of the consulting company. He later became a full partner in the consulting company with 50 percent ownership. His law firm also performed services for the University, which were billed through the consulting company, according to correspondence. These services were performed in the absence of a signed retainer agreement. An attorney in the Office of General Counsel later wrote in August 1993 that he was unable to find evidence that the University had ever attempted to obtain prior written approval from the Attorney General, as required by state statute and System policy.

For consulting contracts in excess of \$10,000, state statute and System policy require that notifications be sent to the Governor's Office of Budget and Planning, the Legislative Budget Board, and the Secretary of State; such contracts must be awarded through a bid process. University management did not send out a Request for Proposals with respect to the consulting contract and failed to make any of the required notifications.

Under the Professional Services Procurement Act and System policy, contracts for certain types of professional services, including accounting and professional engineering, are exempt from the notification, publication, finding of fact, and final reporting requirements which apply to consulting contracts. However, services provided by such professionals which are outside the scope of the profession for which they are registered or otherwise licensed are not considered professional services for the purposes of the Act; they are governed by the requirements for consultant contracts. The president of the company is an accountant by profession. Both he and his partner stated that they were acting as consultants and not in their professional capacities as an accountant and an attorney in their roles on the project.

The University's agreements with the company stipulated that the company would provide engineering-related services. Neither of the principals in the company was an engineer, nor was the company an engineering firm. However, over the twenty-month

period, their billed time and overhead would comprise 62 percent (\$1,256,891) of total billings. All engineering services were subcontracted by the company, and the engineering services provided comprised less than eight percent (\$150,299) of the company's billings.

Two law firms were also subcontracted and billed through the company. Invoices submitted for these firms' services comprised 30 percent (\$611,577) of the company's eventual billings. The University did not obtain prior written approval from the Attorney General for either of these firms.

Except for its initial \$25,000 contract, the University's contracts with the consultants placed no overall dollar limits on the consulting services to be provided. Additionally, all subsequent contracts provided for the company to bill the University for an "indirect burden" over and above its hourly professional and technical fees and expenses. This "indirect burden" was also added to the billings of the company's subcontractors. This ultimately amounted to 25 percent of later direct billings, for a total of nearly \$400,000. A surcharge of this magnitude appears very unusual. Management was not able to explain why the University agreed to this "indirect burden" when they were already paying the consultant their hourly rates plus expenses.

Although the Office of General Counsel was asked to review the first two contracts with the consultants, there is no indication that they reviewed a third contract, which was never signed, or a fourth contract, which was not signed by the University until nearly three and one-half months after its effective date. It also appears the Office of General Counsel saw few of the tasking letters used to define the work to be done under the contract. A significant portion of the consulting services were rendered solely on the basis of management's verbal instructions without additional written support. Services were rendered during one period of nearly seven and one-half months in the absence of a contract signed by both parties. The absence of a contract was acknowledged by University management and the consultants on at least four occasions during this period. Billings for this period totaled approximately \$1 million, or half of the eventual total billings.

For additional information on the cogeneration project, refer to Appendix 3.

The Water Treatment Services Contract Was Not Well Planned Or Managed And Cost The University More Than Twice The Contract Amount. In November 1993, the management of the power plant, a division of the Physical Plant Department, contracted with a vendor to provide water treatment services. The contract was for one year at a cost of \$355,000. By September 1994, 11 months into the contract year, the University had spent approximately \$750,000 on services covered under the contract, many of which were performed by the University and not the vendor as required by the contract. Contract terms not complied with by the vendor include:

- The vendor did not move and install water treatment chemicals; therefore, TAMU employees were required to manually handle these hazardous chemicals.

- The vendor failed to provide chemicals in bulk quantities; instead, the more expensive port-a-feed containers were used, with the University paying the higher price.
- The vendor used caustic chemicals (sulfuric acid) when the Request for Proposal stated that this would not be required. This was a major negotiating advantage the vendor had claimed over competing vendors.

Management personnel at the power plant also made modifications to the contract, sometimes only verbally, causing cost increases.

Other indications that this contract was not very well planned or managed include:

- While the vendor was to update and automate the water treatment facilities, there were no formal plans, drawings, or blueprints diagraming how this was to be done.
- The millwrights, mechanics, and electricians contracted to do the work had to decide what to do as they went along resulting, at times, in redoing work.
- Many of the work orders and requisitions for materials had "rush" or "urgent" stamped on them, indicating hasty decision making.

If the true costs to provide the water treatment services had been included in the vendor's proposal, they may not have received the contract. In fact, at a cost of \$750,000, it may not have been cost-beneficial to proceed with automating the water treatment process. No feasibility analysis was done for this project.

The contract was approved by a buyer in the Purchasing Department and did not follow the University's policy requiring all contracts in excess of \$50,000 to be approved by the Vice President for Finance and Administration. All contract modifications should have followed the University's procurement policies and procedures, such as preparing written addendum, to ensure that proper review and authorization was obtained.

Negotiations For Contracting The University Bookstore Operations Were Not Appropriate. There were several aspects involving the bookstore contract planning and negotiations that were not appropriate. This contract was written and negotiated by the former Chairman of the Board of Regents. Amendments to this contract that were prepared and approved after the signing date appear on the original contract. A University official has been convicted of soliciting gifts from the vendor in connection with a trip to the vendor's New York offices where a five-year extension to the original contract was made.

Two vendors negotiating with the University in 1990 to operate the bookstore did not receive the same consideration in the negotiating process. The vendor eventually selected was allowed the opportunity to increase the value of its proposal, while there was no indication in the records that the competing vendor was allowed this opportunity. The selected vendor was also allowed to make a change to the terms of

the contract eight days after it was signed and approved. However, this change appears on the "original contract."

A consultant was hired by the University to evaluate the two proposals and determined that both vendors were qualified to operate the bookstore. The consultant's recommendation, based on experience of the vendors, was to hire the vendor eventually selected if it could increase its offer to match that of the other vendor, which it did. As mentioned above, the competing vendor was not allowed the opportunity to provide a counter offer.

University officials made six trips to the vendor's offices in New York City between May 1990 and June 1993 at a net cost of more than \$35,000 to the vendor. The costs included airfare (\$14,349), hotels (\$7,936), limousine service (\$6,835), and Broadway theater tickets (\$920). Additional meal expenses paid by the vendor were more than \$5,300. One trip from College Station and Houston to New York was on the vendor's airplane which is not included in the \$35,000.

On four of these trips, the former Vice President of Finance and Administration and the former Chairman of the Board were accompanied by their wives. More than \$8,000 of the \$35,000 costs was attributed to the wives' expenses. The trip to New York on the vendor's airplane was by these four individuals.

The last trip to New York (for four days in June 1993) involved an agreement to extend the vendor's contract another five years. This was the most expensive of the six trips, with the vendor spending more than \$12,000 on the two Texas A&M officials and their wives. Recently, the former Vice President for Finance and Administration was found guilty by a Brazos County jury for soliciting gifts from the vendor, a violation of state law.

Consultant Contract Was Not Approved. In conjunction with a research project (Philadelphia Project), the principal investigator contracted with a consultant without obtaining the necessary review and approval by University officials. On the document, the signature line for the authorized University officer was lined-out and contained no signature; a handwritten note from the principal investigator stated that "it is not necessary for another signature."

Recommendation:

The development and implementation of effective contract administration procedures are needed to manage the University and System's risks and liabilities associated with contracting. These procedures should address all phases of contracting, including planning, acquisition, monitoring, and evaluation.

Management's Response:

In September 1994, the Chancellor formed a task force, chaired by the Vice Chancellor for Finance and Operations, to address the need for an improved, more

formalized contract administration function on a System-wide basis. The task force is responsible for recommending policies, contracting procedures, delegations of authority, an implementation plan and compliance criteria. Its recommendations are to be completed by March 1995.

The President of Texas A&M University recently announced a reorganization which included the formation of a new unit. The new unit will be responsible for the administration of Texas A&M University internal contracting controls. Its mission will be to create and maintain a well-defined administrative control environment to ensure that management exercises its fiduciary responsibilities in contracting on behalf of Texas A&M University.

Section 1-C:

Observe Policies And Procedures Relating To Sponsored Research

Management controls at the University relating to the funding and reporting of research results were not adhered to in the "Philadelphia Project," a research project studying solid state reactions. This project was reportedly attempting to turn base metals into gold. This breakdown in controls cost the University money and media attention, causing embarrassment and ridicule.

Over a period of 18 months, University administration received repeated warnings that the activities of the principal investigator, a distinguished professor in the chemistry department, and his associates were not in compliance with accepted research protocols and University policies and procedures and could be damaging to the University's reputation. However, they failed to take timely action until the press published stories linking the University with the project. Documentation indicates that:

- Management was aware that in the prior ten years this professor had been the principal investigator on two other research projects where he made public announcements boasting of his scientific discoveries prior to a peer review. His claims would later be modified or discredited, causing embarrassment to the University.

Management was also aware of the nature of the Philadelphia Project research, which included the production of precious metals. The controversial nature of this research should have heightened management's awareness of the need to monitor the activities of this project more closely.

- On April 8, 1992, the donor of the funds for this project wrote a letter which was initially addressed to the research associate on the project, who was not a University employee. The letter implied that the associate was affiliated with the University. The letter also invited recipients to "our offices on the campus of Texas A&M University, College Station, Texas, U.S.A." The letter made claims of having synthetically produced "several kilograms of precious metals" and indicated the donor's intent to "receive public recognition

through the patenting and publication of all technologies." This correspondence was reportedly later sent to various individuals and foreign embassies.

The donor's letter was in the Office of the Chemistry Department of the College of Science on April 16, 1992, and subsequently routed by the Interim Dean to the Provost on April 20. Thus, University management was aware of the donor's commercial intentions for the work he was funding at the University and his use of the University's name in his activities.

- On September 4, 1992, the University hosted a dinner for a delegation from the People's Republic of China, and a presentation was given on the Philadelphia Project. University representatives attended this dinner.
- On September 28, 1992, the Office of the General Counsel was informed of a federal subpoena for Development Foundation records pertaining to the project. Also on this date, the principal investigator informed the department head that the donor had brought an unidentified visitor to the University's laboratories, without notice, during the principal investigator's absence. The visitor performed work, the nature of which was not known by University personnel.
- In December 1992, University management became aware of news reports naming the University in conjunction with claims being made by the principal investigator and his associates at a conference in Mexico City. These claims included describing their discoveries "as the greatest advance in modern science." These discoveries had not been subjected to scientific peer review to substantiate their validity. Premature boasting of these discoveries presented potential damage to the University's reputation. Subsequently, University management began to monitor the activities of the principal investigator more closely.
- In April 1993, the Securities and Exchange Commission advised the University to freeze the funds related to the project.

The donor would later plead guilty to defrauding 380 investors of \$11 million in an unrelated securities scam. These investors named the University in a class action lawsuit, alleging that the donor and his associates diverted their money to the University and the Philadelphia Project. Management, upon learning of legal action against the donor and knowing that the professor was one of the donor's associates in a related venture, would not initiate any inquiry of its own until November 1993, after the story of the Philadelphia Project became public; even then its response was limited.

It is accepted practice in science to have research results reviewed by one's peers prior to making public statements regarding those results. Additionally, a letter from the University Provost, dated November 30, 1992, states that "all media releases of Texas A&M University work not reported in appropriate and peer reviewed journals require approval through the Office of University Relations." The University's *Administrative*

Policy and Reporting Manual also states that "A faculty member's comments regarding matters of public concern . . . are not protected free speech . . . if they materially and substantially interfere with the regular operation of the institution, or one of its components."

The funding for this project was not handled in accordance with the University's policies and procedures relating to contract research. The donor's funds for the Project were incorrectly routed through the Development Foundation instead of the Research Foundation or one of the System's components.

According to existing policies and procedures, when a donor provides funds with the expectation of receiving a benefit, such as research reports or the rights to research products, the funded activity is considered contract research and funds are required to be accepted through the Research Foundation or one of the System's components. Funding is subject to an administrative overhead charge of up to 45 percent by the University.

Funds accepted through the Development Foundation must be in the form of a gift, with no expectation of benefit to the donor. The Development Foundation charges a five percent gift fee.

The principal investigator was aware of these policies and procedures and how to circumvent them. In August 1992, he wrote a letter to the research associate discussing a potential additional grant of \$20 million from the donor, which included the following: ". . . there is a legal ritual associated with these donations which the University demands. In order to avoid the draconian 'overhead' (now raised to 45%) which the University subtracts from moneys which are given to the Research Foundation . . . it is necessary for [the donor] to give the money according to a formula which says it is a gift which the University can use as it pleases! The donor then adds his request: It is that the University should devote the money to researches (sic) on . . . under the direction of [the principal investigator]. This formula is 100% fool proof as proved out by me since 1981." The letter then proceeds to discuss plans for the funds, stating in a postscript: ". . . we want to work and make money . . ." Another letter, written the previous day, suggests that the principal investigator and two associates be rewarded \$500,000, as well as 15 percent of the shares of any company set up to exploit their "discovery."

The donor provided a statement in April 1992 indicating that his \$200,000 constituted an unrestricted gift with provisions of how the funds were to be used, and the funds were accepted at the Development Foundation at the end of that month. However, correspondence before and after the acceptance of these funds, some of which came to University management's attention, indicates the donor's commercial intentions for the related research. Nonetheless, the donor's funds were approved by the University for acceptance through the Development Foundation.

Acceptance of the donor's funds through the Development Foundation had the following effects:

- The University lost overhead charges ranging from \$20,000 to \$90,000 that it would have received had the project funding been properly routed through the Research Foundation.
- The principal investigator's activities avoided the administrative and financial oversight and review that would have occurred had the project been funded through the Research Foundation.
- The resulting lack of coordination between the Development Foundation and the University contributed to the failure to properly account for a number of fixed assets on the chemistry department's inventory listing that were purchased for this project.

Recommendation:

Management should ensure that policies and procedures relating to contract research and the acceptance of gifts are followed. Measures should also be taken to ensure that faculty observe accepted research protocol regarding public announcement of their discoveries. Particular attention should be given to the use of the University's name in conjunction with activities such as those noted above, and management should act, when necessary, to protect the University's interests and reputation.

Management's Response:

The University established an implementation task force which developed new definitions of gifts and private grants so that the circumstances in which gifts will be accepted for research are clearly distinguished. These definitions will be included in the University's Policy and Procedure Manual. Where there is an expectation of return by the donor, the research will be administered in the same manner as sponsored contract research, including considerations of indirect costs and compliance with established research protocols. Gift account forms are being modified to require signatures of deans/directors and department heads, to certify compliance with all university policies and applicable state and federal laws, and to document the nature of the intended research.

Management will develop a formal presentation and training program for all current and future faculty, staff, and administrators involved in any aspect of gift solicitation at Texas A&M University and related organizations. The training will focus on policies and procedures involved in accepting gifts and private grants for research with an emphasis on the certification and approvals required for accepting such funds.

A proposed policy to address the presence of non-University employees in University's laboratories, classrooms, and facilities has been approved by the University Research Council and is under review by The Texas A&M University System Office of General Counsel. Final approval by the President is required prior to implementation.

Management is committed to address any violation of state and federal laws, regulations, rules, or institutional policies/procedures immediately, in a manner consistent with the principles of due process.

The target date for implementation of all these changes is February 1, 1995.

Section 1-D:

Improved Compliance With Administrative Policies and Procedures Is Necessary To Assist Management In The Effective and Efficient Use Of Resources

The System and the University have policies and procedures addressing a number of aspects of their operations. However, while responsibility for many activities and related decisions has been delegated downward, it appears that an adequate mechanism has yet to be put in place to ensure that all areas of the University comply with the statutes, policies and procedures, contracts, account restrictions, and generally accepted practices governing their operations.

Observe Competitive Bidding Requirements. Split purchase vouchers were found in the College of Veterinary Medicine (CVM). A split voucher is a purchase of related goods and/or services from the same vendor by issuing two or more purchase vouchers. These vouchers cumulatively amount to at least \$1,000. By splitting purchase vouchers, individuals can circumvent the competitive bidding process. The CVM departments include the Large Animal Clinic, Veterinary Teaching Hospital, Pathobiology, and Vet Med Computer Services.

Purchases of goods and services by governmental entities should be made according to state law and regulations. Texas Administrative Code, 1 Sec. 113.11(e)(1)(A) states that "agencies must attempt to obtain at least three informal bids . . . on all spot purchases in excess of \$1,000."

Furthermore, Texas Civil Statutes, Title 20, Article 601b, Section 3.08(e) states that "large purchases may not be divided into small lot purchases in order to meet the specified dollar limits."

We noted several of the CVM vouchers with handwritten notes that indicate staff intent to split the voucher. These include:

- A note referring to a phone call to a vendor requesting specifically that the vendor invoice be split because it was over \$1,000. The invoice was subsequently split by the vendor to accommodate the request.
- A note asking another employee to "do another order for 80 tomorrow." The original quantity was 160 and amounted to \$1,358.40. When split, the quantity of each voucher was reduced to 80, and the total for each \$679.20.

- Another split purchase indicated that a department paid freight in triplicate as a result of splitting the purchase among three vouchers. If a single voucher had been issued, then only one freight charge would have applied.

In their review of spending by the Board of Regents, the System Internal Audit Department found that videocassette recorders were purchased for which documentation appeared to suggest that orders were split to remain under the \$1,000 level requiring competitive bidding. No competitive bidding was noted.

In our review of purchasing exception letters prepared by the Assistant Director of Procurement Services, we noted 32 examples where departments were not complying with University policy. These 32 letters were prepared over a ten-month period and represent 26 different departments and parts. Three of the 32 exceptions were for split purchases, with the other 29 representing departments that had exceeded their delegated purchasing authority. The Assistant Director only knows if there has been a violation if the Comptroller's Office refers a purchase voucher for review. None of the CVM purchase vouchers discussed above were referred by the Comptroller's Office for review by the Assistant Director, indicating that these referrals are not inclusive of all transactions.

Personnel are using purchasing practices that are not in accordance with state law and System policies regarding the purchase of goods and services. It is possible that personnel are attempting to either expedite the purchasing process or give preference to certain vendors.

When departments split purchases to avoid competitive bidding they increase the risks to the University that:

- Items that are valued at \$1,000 or more will not be placed on the University's inventory, therefore reducing the ability for the University to safeguard its assets.
- Historically Underutilized Businesses (HUBS) are less likely to receive the opportunity to do business with the State. When the University obtains competitive bids, two of those bids must be sought from Historically Underutilized Businesses (HUBS).
- The best price on goods and services will not be obtained. Also, split purchases may result in the payment of additional unnecessary freight expense.

Recommendation:

We recommend that University personnel comply with state law and System policies regarding purchases of goods and services. This includes obtaining three competitive bids on all related purchases of \$1,000 or more. We further recommend that staff be trained on proper purchasing procedures.

Management's Response:

In September 1994, the Board of Regents approved ethics policies for the Board and all employees of The Texas A&M University System. The employee ethics policy has been distributed to all employees, and training sessions are presently being developed and will be implemented throughout the System during fiscal year 1995.

A "Guidelines for Disbursement of Funds Manual" and training module were finalized by the System Comptroller and Human Resources departments in September 1994. Training, to be completed during fiscal year 1995, will be required for all employees involved in the preparation and/or approval of vouchers. In addition, each Chief Executive Officer in the System will annually certify that all employees who prepare and approve vouchers have received and completed disbursement training. The manual includes the following statement:

Purchases should not be split (one large purchase divided into several smaller purchases) in an attempt to circumvent the purchasing rules. In fact, cumulative departmental purchases of \$1,000 or more within 30 days with the same vendor should be competitively bid.

Observe Policies And Procedures Relating To Fixed Assets. We noted that two departments have a number of items on their property inventory that could not be located. The Athletic Department had 48 missing items (5.6 percent of its total inventory), and Veterinary Pathobiology had 70 missing items (8.0 percent of its total inventory).

During our testing, we noted that 19 of 191 fixed assets tested (or 9.95 percent) were not in the location listed in the inventory record. At three of the departments tested, we noted obsolete assets which remain on inventory. Specifically, in our sample we noted three obsolete assets at Veterinary Pathobiology (27.3 percent of sampled items), two obsolete assets at the Physical Plant (5.3 percent of sampled items), and one obsolete item at the Veterinary Teaching Hospital (10 percent of sampled items).

The University's Internal Audit Department performed a physical observation of inventoriable equipment purchased with Philadelphia Project funds. They noted that 3 of 7 items observed could not be reconciled to the chemistry department's inventory list and did not have University asset numbers attached to the equipment. Two of the 7 items were not properly valued on the chemistry department's inventory listing because two invoices for \$486.26 in freight costs were not included on the inventory in accordance with the University's *Equipment Management Manual*.

Several items were reportedly loaned to the Philadelphia Project and another outside entity for over a year; however the Principal Investigator and the chemistry department could not locate the equipment and did not maintain any documentation for the equipment. The Accountable Property Officer was not notified that the equipment was on the premises, and the equipment was not included on the Department's inventory listing, as required by the *Equipment Management Manual*.

Although management has stated that each department is subjected to an annual spot check of fixed assets by the Fiscal Office, these spot checks have not been done in a timely fashion. The Physical Plant's fixed assets have been spot checked twice in the last seven years. The Athletic Department has been spot checked every two to four years.

The University's *Equipment Management Manual* requires that equipment items be properly recorded on a department's inventory listing at acquisition cost, identified by a University property number, and monitored and tracked. It also requires that equipment loaned to the University for more than a year be carried on the University's inventory listing. It provides procedures to be followed in reporting changes in the location of property items and further states that "Accountable Property officers should be particularly conscientious about reporting permanent location changes to Plant Accounting as they occur."

TAMU Policies on Inventories and Inventory Control Procedures (Policy Number 3.1.4) states that "relief from accountability should be sought by the Accountable Officer in all instances where property is . . . obsolete. A request to obtain relief from accountability shall be submitted promptly to the Plant Accounting Office by the Accountable Officer upon discovery of an obsolete asset." The policy further states that it is expected that assets will be carefully reviewed at the time of the regular periodic check of inventory.

In some cases, University personnel are not being notified of the purchase of fixed assets, fixed assets are not being placed on the University's fixed asset listing or are not being capitalized at the proper amount, and fixed asset numbers are not being requested and assigned to property items. Many changes in the permanent location of fixed assets are not being reported.

Failure to add newly acquired property items to the University's inventory listing or failure to monitor and track location changes increases the risk that items will be lost, stolen, or misused. Failure to capitalize property items correctly or failure to identify obsolete assets on a timely basis increases the risk that inventory may be under- or overstated. In addition, in the case of obsolete items, there is an increased risk that the University will not obtain the maximum resale or salvage value for these items. Spot checks provide additional assurance that fixed assets are properly safeguarded and accounted for.

Recommendation:

Management should ensure that all newly acquired property items, including those acquired with external fund sources or loaned to the University, are properly included in the University's inventory listing and that these items are properly assigned fixed asset numbers. Changes in the permanent location of property items should be reported promptly, and items should be reviewed regularly for obsolescence. Management should conduct timely spot checks of fixed asset items.

Management's Response:

Policies and procedures are currently in place to provide for an accurate accounting of Texas A&M University's inventory. The Texas A&M University System Equipment Management Manual states how inventoried items are to be tracked and recorded. The information contained in this manual contains guidelines for departments to use in safeguarding assets.

The enforcement of the above policy has been enhanced by the implementation of a bar coding system in fiscal year 1994 that is used to track inventoried assets. This system allows the Property Management Office in the Fiscal Department to identify more quickly those departments which have an unacceptable percentage of missing items. This information is one of the factors used in a departmental risk assessment. As of September 1, 1994, a risk assessment procedure was started to identify departments with high risk. Those departments with the highest risk are then monitored first and consequently will have a larger number of items verified.

Furthermore, as of October 25, 1994, approval was given to develop a Property Management training class for Alternate Accountable Property Officers. This class will stress the responsibilities as well as recommend internal procedures that could be implemented to aid in their duties in assisting the Accountable Property Officer. The implementation schedule for this class is:

- 1. Class development by no later than June 1, 1995.*
- 2. Conduct pilot class by June 15, 1995.*
- 3. Conduct initial training of Alternate Accountable Property Officers from June 15, 1995 through December 15, 1995.*
- 4. Continual training classes for new Alternate Accountable Property Officers.*

Improve Livestock Inventory System. The inventory records used by the Large Animal Medicine and Surgery (LAMS) department do not accurately account for all livestock owned by the department. The department accounts for livestock using multiple inventory records, including:

- a listing of animals by physical location
- an active animal list (provided specifically to the Veterinary Teaching Hospital)
- quarterly sales and inventory reports to the University Fiscal Office
- separate donation recaps for cattle and horses
- livestock inventory sales report

These multiple inventory records are not employed consistently for all livestock. For example:

- An automated system is in place to account for the physical location of LAMS horses on University property, but no such system is in place for cattle, swine, or other livestock.

- An automated system is used to generate reports on animals admitted to the Veterinary Teaching Hospital. While most livestock are removed from this system after release from the Hospital, horses are not.
- The department does not assign appropriate values to donated livestock.
- The department does not include all donated animals on its inventory report that is submitted to the University Fiscal Office. Thus, the livestock information that is reported to the Fiscal Office is not a true reflection of the LAMS animal inventory.
- The department does not include purchased animals or newborn animals that are produced by the department on the inventory report to the Fiscal Office until the animal has been at LAMS for at least one year. Because of this practice, a purchase of animals for over \$41,000 in fiscal year 1993 was never included on LAMS inventory reports to the Fiscal Office.

Using the inventory records, we were unable to determine the location of various livestock without the additional assistance of the department manager.

The animal inventory system should allow for the tracking of all animals from arrival at LAMS to final disposition. The system should be designed in a manner which would allow departmental personnel and the Fiscal Office to determine the status of all animals owned by the department.

The System's *Administrative Policy and Reporting Manual* requires that donated animals are to be placed on inventory at an estimated fair market value. The related policy statement, effective November 10, 1980, also establishes values to be assigned to all types of livestock owned by the University. These values are most likely unrealistic by today's standards; however, the policy further states that "the department head may assign a more realistic value on an individual basis."

The same policy statement also requires that newborn animals produced by the University be placed on the inventory listing at the date of birth at an arbitrary value, with subsequent adjustments for any change in value.

The inventory system has not been properly designed to account for all livestock owned by the department. Additionally, the department has not used the University's policies for valuing livestock. Instead, the department has relied upon practices that date back over twenty years.

A failure to account for all animals owned by the department could result in inaccurate financial reporting and an inability to safeguard animals against loss or theft.

As discussed, only the department manager appears to be able to track the department's animals using the current inventory system. In the event that the manager is unavailable for an extended period of time, the department might be unable to locate its animals using the current system. Heavy reliance on only one person may prevent the department from safeguarding its assets.

The department's livestock is not accounted for according to System policy. When donated and newborn animals are not placed on inventory reports, the Fiscal Office is not informed of the actual number of animals owned by the University, with the result that LAMS inventories may also be underreported externally.

Recommendation:

We recommend that LAMS implement an inventory system that is capable of tracking the status of all animals owned by the department. At the very least, the system should indicate the beginning and ending inventory of all animals on a monthly basis, whether donated, purchased, or produced by the department.

The Large Animal Medical and Surgery department should include both donated and newborn animals on its livestock inventory reports to the University Fiscal Office. We also recommend that the department value donated and newborn animals on inventory according to the methods prescribed by System policy.

The System needs to update its policies for accounting for donated and newborn animals to reflect current prices. The Texas Agricultural Experiment Station (TAES) has established values for livestock that would more accurately reflect current livestock prices. These prices were established for fiscal year 1995. Although the prices established by TAES are contrary to System policies, they could serve as a model for any revisions of the System policies.

Management's Response:

The animal inventory system in the Department of Large Animal Medicine and Surgery is being modified to incorporate valuation procedures currently employed in the Texas Agricultural Experiment Station policy. The department head will assume a more active role in safeguarding the animal resources of the department by reviewing the animal inventory on a monthly basis, whether donated, newborn, purchased, or produced by the department. The resulting changes in operations will be in place by March 31, 1995.

Ensure The Appropriate Use Of All Funds. Weak management controls have contributed to inappropriate use of funds over the last few years in various departments and functions. To get a perspective of the types of control problems over the use of funds, we reviewed internal audit reports from the System and University internal audit departments for fiscal years 1992, 1993, and 1994. In these reports, and during the course of our own work, we noted a number of instances in which it appears that public funds have not been used appropriately. These occurrences were a result of weak management controls which did not ensure compliance with the related statute, policies and procedures, contract terms, or account restrictions. Following are some examples of inappropriate uses of funds.

- purchase of alcohol by the Athletic Department, in violation of an appropriation rider on Intercollegiate Athletics (General Appropriations Act, SB5, Regular Session, Article III, Section 11)
- the use of University long distance services for personal telephone calls
- purchase of food, beverages, and floral arrangements with departmental improvement funds
- the use of Clinic funds for music therapy for faculty and staff, which was actually payment of a string quartet for playing at a Christmas party
- unauthorized purchases using University gasoline credit cards and the altering of departmental purchase vouchers

In September 1994, Texas A&M University and System officials implemented action to address these types of control weaknesses. These actions included the development and publication of an "Ethics Policy for Employees of the Texas A&M University System," "Guidelines for Disbursement of Funds" handbook and a training module. According to a System official, disbursement of funds training sessions were begun in November 1994 and have been generally well received by participants. We commend management for these efforts to improve controls.

Recommendation:

We commend management on their efforts and encourage them to continue to strengthen controls and accountability for the use of funds.

Management's Response:

We appreciate the State Auditor's support for our initiatives to continue strengthening controls in order to ensure appropriate use of funds entrusted to us.

Section 2:

Improvements In Human Resources Management Are Needed For Hiring, Training, And Evaluating Personnel

Not all departments are following University policies and procedures relating to human resources management. The Human Resources Department does not have monitoring processes to determine departmental compliance with applicable policies and procedures. In fiscal year 1994, the University expended nearly \$261 million in salaries, wages, and benefits for its 7,500 employees. These expenditures represented 49 percent of the University's current funds expenditures for the year.

Much of the responsibility of personnel hiring, training, and performance evaluation has been relegated to the individual departments of the University. However, there has not been a corresponding delegation of accountability for properly managing these activities.

Following are observations and recommendations for improvements regarding management of human resources.

Section 2-A:

All Hiring Of Non-Faculty Positions Should Be Coordinated By The University's Human Resources Department

Individual departments are allowed to fill non-faculty vacancies with walk-in applicants that do not go through the screening and qualification process in the Human Resources Department. By not using the Human Resources Department's expertise in screening applicants the risks are increased that:

- Applicants being considered may not meet the minimum qualifications for the job.
- The most qualified people will not be hired.
- University goals related to EEO may not be met.

The *University Policy and Procedures Manual* (section 2.2.4) requires all non-faculty personnel hired by the University to be screened through the Human Resources Employment Office. The only exception is for those positions which are filled internally.

There are three ways the University fills vacant positions:

1. Applicants are screened for a position by the Human Resources Department and referred to a department for a job interview if they meet the required qualifications. The Human Resources Department prepares a referral card for each qualified applicant and sends them to a department with a position posted as vacant. These cards are to be returned to Human Resources noting why an applicant was not hired and who was chosen.
2. Internal departmental promotions are also used to fill positions of employees. These individuals are not required to be screened through the Human Resources Department.
3. Walk-in applicants who go directly to the department with the vacancy are hired, therefore bypassing the Human Resources Department.

One primary purpose of the referral cards is to assist in Affirmative Action reporting. According to statistical information included in the University's 1994 Affirmative

Action Plan, most higher salary level positions in the reported job categories are underutilized by minorities and women.

Often, when a new hire is through a walk-in or an internal promotion, no referral card is returned. When this occurs, the Human Resources Department has to telephone the hiring department to find out what happened.

The support for departmental hiring decisions are not well documented. Of the eight departments reviewed for documentation to support hiring decisions, one department had support for half of the hiring decisions in our review. Seven departments had little, if any, support to document their hiring decisions. Much of the decision process is through verbal comments received from individuals involved in interviews with the applicants.

Without appropriate support, the departments may be unable to explain or defend their hiring decisions if discrimination is charged.

Federal law (29 CFR 1602.49) requires the retention of records for a period of two years from the date of hire. Documentation should support decisions made through the interview process, including the criteria used to judge the adequacy of the applicant's experience and education. There should also be support to identify why applicants are selected for subsequent interviews or hired for the position. This would apply to new hires as well as promotion decisions.

Recommendation:

Established policy needs to be followed by all departments for all applicable new hires. In order to ensure compliance, the University could refuse to process payroll transactions for any new hire when the department has not supplied the Human Resources Department with the appropriate documentation.

Management's Response:

On September 28, 1994, the President issued a letter informing the University community that "offers of employment will be processed for payroll only after certification by the Human Resources Department." Human Resources has developed and proposed a new policy and procedures to support this responsibility.

The President's letter raised University-wide awareness. The number of job vacancies which are now being listed with the Human Resources Department has increased. The policy and procedures are ready for implementation, pending a decision by the President to post all vacant positions and eliminate the exclusion for positions filled by internal transfer or promotion. New materials, which will be provided to hiring supervisors and increased training, will strengthen hiring supervisors' interview procedures, documentation and record retention.

Without documentation that the proper policy and procedures have been followed, the Human Resources Department will not certify a hire for addition to the payroll.

Section 2-B:

Improvements In Monitoring And Documenting The Training Received By Personnel Are Needed To Gauge Their Level Of Development

The responsibility for monitoring employee training has been delegated to each department. However, our reviews of departmental personnel files indicated they do not all maintain complete records of the training received by their staff.

A well-trained work force is necessary for the University to efficiently and effectively meet its mission. The University needs to be able to accurately track the training its personnel have received. By knowing what has been received, future training needs may be identified to address specific development needs.

Recommendation:

Each department should establish a system for tracking the training received by their staff. Perhaps the Human Resources Department could assist in the design of a uniform system for departmental use.

Management's Response:

The Human Resources Department is evaluating training software which, using current technology, will track employees' training. One factor in evaluating the software packages is the ability to use it campus wide. Evaluations should be completed by February 1, 1995.

Computing Information Services is leading an initiative to revise the current main-frame computer system and to create a pc-based human resource information system. These contemplate the capability for on-line entry and tracking of training.

More importantly, the Human Resources Department will implement a Supervisory Academy in April, 1995. This will provide basic and advanced training in supervisory and managerial skills based on the development of core competencies.

Section 2-C:

Personnel Actions Need To Be Supported By Objective Employee Performance Evaluations

Our review of 54 personnel files for employees that had either been promoted or received a merit raise during fiscal year 1994 indicated that 22 were not supported by

either current or above average personnel evaluations. These 54 files were selected from eight departments.

The *University Policy and Procedures Manual* (Section 2.1) requires that evaluations be conducted annually. In addition, to be eligible for a merit raise an above average evaluation is required.

For non-faculty positions, the evaluation forms prescribed by policy do not provide sufficient guidance or structure to allow for an objective evaluation. This is particularly true for classified positions. Seven job dimensions are presented with five levels of proficiency that include general descriptions of performance. The evaluator puts an "X" through one of the five proficiency levels to indicate the employee's performance.

The seventh job dimension, dependability, is not always job related and, therefore, may not be an appropriate attribute to evaluate all employee performance. This dimension asks "How faithful is this employee in reporting to work and remaining on the job." It may not be appropriate, for example, to evaluate an employee's performance based on the amount of leave that they have taken in a given time period. Recent case law has supported this by denouncing such absenteeism policies. Also, recent employment legislation (i.e. Americans With Disabilities Act and the Family and Medical Leave Act) have broadened protection for employees who use leave for certain reasons.

The lack of objective evaluations to support personnel actions (merit increases, promotions, and demotions) increases the risk that inconsistent and subjective judgment is used to rate an employee's performance. An objective evaluation documents and rates an employee's behavior as it relates to performance of defined job dimensions. This would include specific observed behavior in performing job-related tasks.

Recommendation:

Department heads should approve promotions or merit increases only after reviewing current evaluations for appropriate support. Also, to help ensure that evaluations are completed in a timely manner, a staff listing should be used to indicate the date the annual evaluation was received.

To assist in an objective evaluation process the forms should be revised to allow for quantitative and/or qualitative support for rating levels. In addition, space needs to be provided to include specific examples of behavior to document and support those rating levels.

Management's Response:

Vice Presidents, or their designees, who approve merit increases will be provided with documentation which states that each employee has a current appraisal and is rated at least above average.

The Human Resources Department is pilot testing an improved performance appraisal system for managers and supervisors which will be a factor in determining individual development plans. This will, if proven effective, be expanded to all professional/administrative employees.

During the first quarter of 1995, the Human Resources Department will appoint a focus group to develop an improved evaluation procedure for classified employees. The Department of Human Resources offers training and information to supervisors and will make sure this is clarified in future sessions.

Section 2-D:

Improvements In Leadership Of The Power Plant Are Needed To Raise Employee Morale And Comply With University Policies

Dissatisfaction with management of the Power Plant is high among the 91 employees of the department, while morale is low. Plant employees expressed concerns that management did not treat employees fairly and did not manage department operations efficiently or effectively. These concerns included:

- using the apprenticeship program as economical labor for the power plant and not providing supervised on-the-job training for apprentices
- dual standards of treatment
- job misclassifications
- inaccurate personnel records to support disciplinary actions

Power Plant personnel account for just over one percent (91/7,500) of the University's workforce. However, these employees comprised nearly 50 percent (16/33) of the calls we received during our audit fieldwork concerning University operations. In addition, the 51 Power Plant employees responding to our survey regarding their quality of work life had generally negative responses.

Our review of employee concerns found the following:

- The apprenticeship program initiated for the Power Plant in fiscal year 1991 is not providing sufficient on-the-job training by journeymen personnel. Apprentices' on-the-job training has been to learn by trial and error, or by instruction from more senior apprentices. Beginning apprentices have made rounds by themselves to take the readings from meters and gauges on various pieces of equipment. They told us that they were not always sure how to take a reading and what an acceptable reading looked like. This situation caused safety concerns among employees of the Power Plant.

Written standards have not been established, or documentation maintained, for on-the-job training of apprentices. Only work relating to boilers has specific task lists. There is little support to document the observation by journeymen of apprentices successfully performing various tasks. A training assignment form was developed for this purpose. However, it was only used from June to August 1993. Without appropriate records documenting an apprentices' successful completion of all tasks, there is no assurance that competence has been achieved in the required disciplines.

The Power Plant apprenticeship program consists of four skilled areas. However, most of the apprentices have been limited to work in the area of Power Plant operations. They have not been rotated through the skills of instrumentation/controls technician, Power Plant maintenance mechanic, or lab technician. This situation may prevent the apprentices from gaining the necessary exposure to the full curriculum of the program.

The Power Plant has been relying on the apprentices to operate the Plant, and this has caused the situations mentioned above. The journeymen's first priority has to be keeping the plant operations on line, and then any additional time may be used for training apprentices. Everyone on the shift, journeymen and apprentices, have individual jobs to do, usually independent of each other.

The Standards Of Apprenticeship Training For The Physical Plant Department of Texas A&M University contain the requirements in each of the areas identified above. These *Standards* were developed by the University in cooperation with the Bureau Of Apprenticeship and Training, U.S. Department Of Labor.

Recommendation:

To operate an apprenticeship program that appropriately trains apprentices in the four disciplines of Power Plant operations, the University should create an environment that provides for the necessary mentoring and coaching. This training should be appropriately planned and documented to monitor the apprentice's on-the-job training requirements.

Management's Response:

We will organize and implement a new apprentice program, to begin in January 1995. The new program will establish and provide the necessary mentoring and coaching environment. This program will also be planned and documented in order to monitor the on-the-job apprentice training requirements.

- Management requires three days' notice for personal leave of employees but not for themselves. On July 25, 1994, the Assistant Power Plant Superintendent took four hours of annual leave but did not submit a request until July 26. A Power Plant Operator was reprimanded by this same Assistant Superintendent for submitting a request for annual leave after taking the leave.

This type of dual standard, whether perceived or actual, is not conducive to effective leadership and has contributed to the low morale among the Power Plant personnel.

Recommendation:

The University should ensure that there are legitimate business reasons for setting different standards for employees. In the case of leave notification and approvals, a policy should be established which states if there are different rules for management and non-supervisory employees.

Management's Response:

The Utilities Plant requires three days notice for employee absences due to the nature of shift work and continuous operation. However, exceptions are and may be granted when there is an urgent need or personal emergency situation. The policy covers all employees, management and non-supervisory, as instructed by the Interim Director of Physical Plant by memorandum effective December 1994.

- There were two instances where an employee's personnel records apparently contained an error. These inaccurate records were used to support disciplinary action against the employee. On May 19 and July 1, 1993, a Power Plant Operator was reprimanded for not giving sufficient notice for being absent on days he was actually present and working. The two written actions were put in the employee's personnel file and subsequently made him ineligible for any merit raises or promotions. When we asked him why he signed the notices if they were not true, he said that he was afraid of retribution from management if he refused.

Word of this situation has circulated among Power Plant employees and further contributed to the low morale. It has enforced the belief that management of the Power Plant has little regard or respect for the workers' well being.

In an April 1992 memorandum from the Director of the Physical Plant to Physical Plant employees regarding conduct in the work place, he said: "Discrimination, harassment, unjust discipline, and abuse of power are clearly

prohibited in University policy and will not be condoned in the Physical Plant." The Power Plant is a part of the Physical Plant.

Recommendation:

The University should take action to see that employees are not expected to work in an atmosphere of fear and oppression. All employees should be made aware of the University's grievance procedures. Employees should be encouraged to seek assistance from the Human Resources Department on issues where they believe their employment rights have been violated.

Management's Response:

All utility plant employees have been informed, and assured by the Interim Director of Physical Plant, of the establishment of a work atmosphere free of fear, discrimination, harassment and unjust discipline. Employees were also reminded in December 1994 of the existing Grievance Procedure of the University.

- The sick leave policy implemented by the superintendent of the Power Plant required only certain employees to provide a doctor's statement, even if the duration of the sick leave was less than three days. The superintendent classified employees use of sick leave from "best" to "worst." Those employees in the "worst" group had used more than 85 percent of their accumulated sick leave and 96 or more hours taken per year.

The superintendent identified 11 employees who were in the "worst" category. He wrote one of his supervisors that "I do not intend to consider any of these 11 people for a promotion or a merit pay raise." The supervisor was instructed not to recommend 9 of the 11 employees that were under his direction for a raise. The superintendent also told the supervisor that employees not at work, due to sick leave, should have this negatively reflected in their performance evaluations.

The supervisor did not agree with the superintendent's sick leave policy. Three months after receiving the superintendent's sick leave policy, the supervisor was criticized by the superintendent for not carrying out this policy and instructed to stop approving sick leave for certain employees. Ten days later, the superintendent notified all Power Plant personnel that the supervisor had been relieved of his responsibilities related to supervision of personnel.

This sick leave policy creates a separate group of employees who are to be treated differently. The effect could be possible discriminatory practices. In addition to being unfair, this practice could expose the University to related legal liabilities.

Recommendation:

The Human Resources Department should be consulted before a department establishes leave policies different than those of the University. This is particularly so when the departmental policies are more restrictive than those of the University. In general, the University and its departments, should have a sick leave policy that is in compliance with all state and federal employment laws.

Training should be provided to all managers and supervisors for applicable employment law and the risks associated with violating them.

Management's Response:

All sick leave policies currently in use are those established by the Human Resources Department for the entire University. Training for managers and supervisors on this matter will be scheduled with Human Resources. This will occur in 1995 at the earliest date that Human Resources can schedule the sessions.

- Power Plant personnel are performing job duties not consistent with their job titles and descriptions. These include two Operators functioning as Assistant Operators or below and a Power Plant Operations Supervisor functioning as an Operator.

Recommendation:

The University's Compensation/Classification staff should perform routine reviews of positions to determine the appropriate job classifications. There should be an appeal process where employees who believe they are misclassified can request an audit of their position.

Management's Response:

The appropriate classifications will be made upon approval of the utilities organization plan now under review in the Vice President's office. A majority of positions were reviewed and most were rewritten as a part of this new organizational plan. The balance of positions will be reviewed within 24 months according to the Physical Plant Strategic Plan.

Employees who, after implementation of this plan, believe they are misclassified may seek a position audit via the complaint and appeal process. This will be re-emphasized with implementation of the reorganization plan.

- The former Director of the Physical Plant approved the use of compensatory time for exempt level employees without having the President's approval, as required by University policy.

University policy (classification number 2.1.5.1) states that "employees may, at the discretion of the CEO, be granted equivalent compensatory time off. . . ." However, the Manager of Compensation at the University Human Resources Department stated that the President (CEO) had not approved the taking of compensatory time by any University employee.

Recommendation:

The Physical Plant should follow University policy regarding the granting of compensatory leave.

Management's Response:

Since the University and Physical Plant administration has changed since February 27, 1993, this policy has been rescinded by the Interim Director of Physical Plant. The Utility Plant now follows University policy on compensatory leave. This was accomplished through a November 1994 memorandum.

Section 3:

The University Needs To Efficiently Coordinate Information Resources

The University does not coordinate administrative information resources that are used throughout the various departments.

- Strategic planning of information resources does not address the various areas throughout the University. The University's 250 departments independently determine what automated resources will be purchased, developed, and implemented for administrative computing. The Computing and Information Services (CIS) strategic planning process only addresses applications maintained within that department.
- A representative sample of users is not included in the committees who design and guide the development of automated systems.
- The University does not provide policies for automated systems that will be followed by all departments.

Without coordination of standardized administrative systems, the University is spending additional funds to do the following:

- Develop and maintain duplicate systems in the various departments.

- Re-train employees transferring between departments that use different administrative systems.
- Provide training for staff on a multitude of commercial software packages.
- Reconcile between strategic application data and department data.

Recent legislation has encouraged better coordination of information resources. The Information Resources Management Act (Government Code, Title 10, Chapter 2054, subchapter A) states that:

- Danger exists that state agencies could independently acquire uncoordinated and duplicative information resources technologies that are more appropriately acquired as part of a coordinated effort for maximum cost-effectiveness and use.
- The sharing of information resources technologies among state agencies is often the most cost-effective method of providing the highest quality and most timely governmental services that otherwise could be cost prohibitive.
- Both consideration of cost and the need for the transfer of information among the various agencies and branches of state government in the most timely and useful form possible require a uniform policy and coordinated system for the use and acquisition of information resources technologies.

The Information Resources Management Act addresses coordination between agencies. For an organization as large as Texas A&M University, these issues are also valid for coordination among departments.

Section 3-A:

User Representation In The Design Phase Of Automated Systems Would Minimize The Costly And Inefficient Need For Duplication of Systems And Data Entry

The committees planning the Budget/Payroll/Personnel (B/P/P) system modifications do not include representation by the users, who will enter and rely on that system's data. The needs of the system are being addressed by three committees of specialists, one for each major function: the Budget Committee includes only budget office personnel; the Payroll Committee includes only payroll office personnel; the Human Resources Committee includes only human resources personnel.

While the expertise of these individuals is needed in the system's design, the users of the system can also provide valuable input. Without this input, the risks increase that a system will be designed and implemented that does not meet the user's needs. This has already been evidenced by the evolution of the University's central financial system, FAMIS (Financial Accounting Management Information System).

Although FAMIS has been successful in enabling the University Fiscal Office to gather financial information, FAMIS does not provide useful information at the departmental level. The reporting capabilities of FAMIS have not been fully realized since the annual financial report preparation is completed through a personal accounting application computer spreadsheet software. Even though FAMIS has had a general accounting ledger since 1991, University departments have continued maintaining, purchasing, and developing individual departmental accounting systems. An environment with a high degree of end user computing is an indication that the central systems are not meeting needs.

In reviews by the State Auditor's Office and System Internal Audit, a combined sample of 42 departments revealed that these departments were using a total of 24 different administrative systems to maintain information. (The Internal Audit review was reported in the *Texas A&M University System Management and Control Review, Alcohol Procurement and Payment Practices*, April 11, 1994.) Many of the administrative information systems used by departments require duplicate data entry by departmental personnel. We observed departments entering the same data from one to five times within their own department. The same data is also entered into FAMIS.

The Fiscal Office estimates that, for fiscal year 1994, \$1.3 million was expended to process over one million accounting transactions through FAMIS. If departments were able to eliminate processing duplicate transactions, the University could redirect approximately \$1 million each year to more productive uses.

FAMIS was designed and developed with input from multiple committees. These committees have been well represented with members from University fiscal management, System Parts, and the FAMIS team, however, academic departments have had limited representation on the task force committees and none at the high-level steering committees.

The academic departments at the University could benefit from and provide input to the user's perspective during system design and development. With their input during the design phase a sense of ownership could be fostered into a system that addresses their needs, reducing the need for inefficient duplicate data systems and entry.

There have been plans for additions to FAMIS that will give departments more useability. However, module implementation was given a lower priority in favor of including more System Parts on FAMIS. Now that most System Parts are using FAMIS, management has indicated that attention to departments' needs will be addressed. Planned additions include purchasing, payroll interface, departmental budgets, and support accounting.

Recommendation:

Efficiencies in administrative data processing should be implemented to reduce the amount of duplication involved in entering and processing data, resulting in cost savings for the University.

As the University develops or modifies automated systems such as the Budget/ Payroll/Personnel (B/P/P) system, end users should be included in the design and development. In addition, the University should evaluate current processes and determine whether modifications should be made to existing applications prior to spending resources on new automation systems.

The System should consider future automation needs and the cost analysis for achieving information systems that will ensure standardized useful administrative systems. Costs comparisons of computing options should include costs for transactions, duplication of effort, and providing control over data.

Management's Response:

We concur with the recommendation to improve administrative data processing efficiencies to FAMIS. The purchasing module of FAMIS is being released to key pilot departments for use during January and February 1995. In the Spring, it will be released to all users as training is completed. The purchasing module is fully integrated with the accounting functions of FAMIS and will allow an on-line purchasing process for most purchases.

Licensing agreements for a software package have been finalized, and it will be distributed in January 1995. The package will allow end users to download FAMIS data to their microcomputer environment so that data can be processed to meet end users' needs.

The implementation of departmental bookkeeping aspects within FAMIS is under discussion, and will be addressed during the Spring Semester 1995.

End users will be included in the design and development of B/P/P.

Future automation assessments will include appropriate cost analyses.

Section 3-B:

The University Needs to Follow Policies for Automated System Development, Maintenance, and Control

The University is not following policies and procedures for systems development, maintenance, and control. The departments sampled revealed few procedures and practices that protect their investments in end-user computing.

Without standardized policies and procedures for systems design, acquisition, and support, the University has risked excessive costs in maintaining systems that:

- were implemented without the benefit of sound development practices
- provide minimal documentation for automated systems developed by departments

- are inconsistent and incompatible with computer equipment and software throughout the University
- have weak security controls over department computer environments
- have minimal back-up and recovery controls at the department level

Department Is Unable to Use Their Administrative System

During our review, we interviewed a new employee who is responsible for operating a department's administrative computing system. The employee was unsure how the system worked and was unable to find out without calling the former employee who had retired a few days earlier. The system was not documented, and the operating knowledge left with the retired employee.

It is estimated that 80 percent of the total cost of an automated system (over its useful life) is spent during maintenance. Effective planning during the development process can reduce the amount of maintenance required for a system, thereby reducing the total resources expended on a system.

System documentation will reduce system maintenance costs by reducing the amount of time spent on learning a system when changes or corrections are required. System documentation will also reduce the amount of time required to teach the system to a new employee.

Security over end-user computing is necessary because of personnel changes, disk drive failure, and a lack of audit trails associated with using personal computers. Security for personal computers is required in the *Information Resources Security and Risk Management Policy, Standards, and Guidelines* published by the Department of Information Resources.

Recommendation:

The University needs policies that will be followed by all departments to coordinate information resources. The University should not have different systems with different types of software and hardware addressing similar needs. Procedures should be established for standards for personal computer equipment, operating systems, and applications software to ensure compatibility within the University. Constraints need to be placed on the alternatives for both equipment and software for end-user computing.

End-user computing should be included in the Strategic Plan for Information Resources and the Biennial Operating Plan, along with University strategic systems.

Procedures are also needed for end-user security, development standards, documentation requirements, and back-up and recovery controls. Procedures should ensure that both computer hardware and software is installed, operated, and maintained properly; protected from misuse and damage; physically secure; and supported by expert technical assistance. There are procedures for security and development standards established by the University. Departments should be

following these procedures, or the University should develop procedures more applicable to end-user computing.

Management's Response:

We agree that policies are needed to coordinate and ensure compatibility, as appropriate, for personal computer equipment and software applications.

There is a single student information management system (SIMS), a single accounting system (FAMIS), a single payroll system (B/P/P) for Texas A&M University. These systems can be accessed in a variety of ways consistent with the needs of the users. Resources are coordinated in terms of network access, security procedures, as well as access to these applications.

The Computing and Information Services Department has begun to adopt, as part of its strategic planning process, continuous improvement. A quality council has been established which will charter continuous improvement teams. Initial areas to be addressed include departmental support, consistent levels of support and resource sharing, and how to integrate and coordinate needs to best meet the requirements of end users.

Texas A&M University published the Computer Security and Data Ownership: Rights and Responsibilities document in 1992. The policy is being revised and will be reissued in early 1995. It will be distributed to all Texas A&M University departments.

Objective, Scope, And Methodology

Objective

Our audit objective was to evaluate the existing management control systems within Texas A&M University and the Texas A&M University System Administrative and General Offices to identify strengths and opportunities for improvement. Included was a review of the University's financial controls over the use of state funds.

After we were on site, we became aware of a recent management study that had been done at the Texas A&M University System Administrative and General Offices by an outside firm. Our review of this study and management's initiatives to implement the report recommendations caused us to shift our audit focus to the University's operations.

Our audit was originally scheduled to be done during fiscal year 1995. However, in response to a legislative request to review certain University activities, we moved the audit up to our fiscal year 1994 audit plan.

Scope

The scope of this audit included consideration of management's oversight, the use of public funds, contracting procedures, human resource management, information resource management, and the economy and efficiency of operations.

Consideration of management's oversight of University operations included a review of:

- the planning and monitoring process of departmental operations
- involvement by various levels of management in the decision-making process
- channels of communication in the decision process
- the ability of management to take corrective action when appropriate
- how controls are overridden by management

Consideration of the University's use of public funds included a review of:

- University policies and procedures, state law, and federal requirements governing how funds are to be used
- compliance with current policies and procedures
- the monitoring of compliance requirements
- the fixed assets and livestock inventories

Consideration of the University's contracting procedures included a review of:

- current policies and procedures and state laws related to contracting for services

- the cost-benefit analysis involved in the decision-making process
- the preparation, review, and approval process

Consideration of the University's human resource management included a review of:

- recruitment and selection
- the system to review and document employee performance
- personnel actions
- the use of leave policies
- personnel training needs identified and addressed

Consideration of the University's management information systems included a review of the:

- planning and design of automated systems
- ability of systems to efficiently meet user needs
- coordination of information systems

Consideration of the University's management of sponsored research projects included a review of:

- the funding process
- monitoring of research activities
- disclosure of developments and discoveries associated with research efforts

Methodology

Information collected to accomplish our objectives included the following:

- Interviews with the Board of Regents, management, faculty, staff, and vendors of Texas A&M University System Offices and/or Texas A&M University
- Documentary evidence included a review of:
 - internal and external correspondence relating to University operations
 - University plans, goals, budgets, policies, and procedures
 - personnel files, payroll records, personnel action forms, personnel evaluation forms, and job descriptions
 - various contracts for services and Request for Proposals
- Job satisfaction survey of employees of the Power Plant
- Review of internal audit reports, from both the System Office and University internal audit departments, for the last three years
- Newspaper articles relating to activities of Texas A&M University and/or its faculty and staff

Procedures and tests conducted:

- Review of correspondence and documentation relating to University operations (cogeneration project, Philadelphia Project, Bookstore contract, etc.)
- Direct testing of both the fixed assets and livestock inventory systems
- Compliance testing of personnel files
- Compliance testing of purchase vouchers
- Observation and review of departmental administrative computing applications on a test basis
- Review of contracts for services to determine compliance with University policies and procedures and state law

Analysis techniques used:

- Control reviews
- Data comparison
- Process review

Criteria used:

- State and federal law
- Texas A&M University policies and procedures
- State Auditor's Office Accountability Project Methodology (general and specific criteria)
- State Auditor's Office Management Control Methodology

Other Information

Fieldwork was conducted from June 16, 1994, through September 30, 1994. The audit was performed in accordance with applicable professional standards, including:

- Generally Accepted Government Auditing Standards
- Generally Accepted Auditing Standards

The audit work was performed by the following members of the State Auditor's staff:

- Dick Dinan, CPA (Project Manager)
- Arthur Arispe
- Rob Bollinger, CPA
- Verma Elliott
- William Hurley, CPA
- Andrew Knight
- Teresa Menchaca, CDP
- Ed Pyun, CPA
- Ryan Simpson
- Pamela Spencer
- Eric Williams

- Brenda Winkler, CQA
- Catherine A. Smock, CPA (Audit Manager)
- Deborah L. Kerr, Ph.D. (Audit Director)

Department Profile

Mission and Goals

In its mission statement, Texas A&M University " . . . aspires to preeminence in teaching, research, and public service, with quality and scope that prepare for the future as well as illuminate the present."

Goals identified to carry out the University's mission include:

- "To provide an ever-improving academic program of the highest quality of undergraduate and graduate students alike.
- "To contribute important additions to society's knowledge through world class research and scholarly activity, . . ."
- "To offer programs responsive to the issues of the society in which we live, and to contribute directly to the improvement of society by programs of public service and outreach."

Background

By resolution of the Legislature in November 1866, the State of Texas agreed to provide for a college under the Morrill Act of 1862. The Legislature subsequently acted to establish an institution in 1871, and the school opened for classes in 1876 as the Agricultural and Mechanical College of Texas, a land-grant college and the first public college in the State.

By 1920, the Agricultural and Mechanical College was the center of a system of six institutions and agencies under the governance of a president and Board of Directors. In 1948, acting on recommendations of a 1947 Joint Legislative Committee, the Board of Directors formalized the organization as the Texas Agricultural and Mechanical College System. In 1963, the Legislature changed the Agricultural and Mechanical College's name to Texas A&M University, reflecting the diversity and expansion of the College's curricula.

Operations

The Texas A&M University System today consists of seven state universities and eight agencies focused on technology, science, and management. The System's seven universities serve more than 75,000 students. Research projects administered by System universities and research agencies total \$308 million. System employees teach seminars, workshops, and short courses to more than 3.5 million annually as a part of the System's service mission.

The System employs 19,000 full-time faculty and staff members. The budget for the Texas A&M University System statewide network exceeds \$1.19 billion.

In 1971, Texas A&M University was designated a Sea Grant College, and in 1989 it was designated a Space Grant college, becoming one of a select few institutions nationwide to hold the triple Land Grant, Sea Grant, and Space Grant designation. Today Texas A&M University is the third largest university in the country, with more than 43,000 students and more than 2,500 faculty members. The University aspires to preeminence in teaching, research, and public service, and supports the international activities of its students, faculty, and staff.

With its 10 colleges, the University offers 151 fields of undergraduate study, 148 at the master's level, 105 at the doctoral level, and professional degrees in both medicine and veterinary medicine. In addition to its main campus in College Station, the University also operates a campus in Galveston; the Santa Chiara Study Center in Castiglione Fiorentino, Italy; the James Earl Rudder Scholars Program in Caen, Normandy, France; and is the future home of the George Bush Presidential Library Center.

Texas A&M University ranks sixth in the nation in endowment funding (with more than \$1.6 billion) and eighth in research (with \$305 million in expenditures).

A Detailed Review Of The Cogeneration Project

Background

In June 1992, Texas A&M University (TAMU) began efforts to have a new cogeneration plant built on its growing West Campus to meet its long-term energy needs through the year 2012. The project, which would be the largest capital project in the University's history, was begun even though management had not determined with certainty:

- how much the plant would cost (estimates of the project's cost ranged from an initial figure of \$75 million to as much as \$120 million)
- how it would be financed
- what the University's true energy needs were, and how they would dispose of excess generated power (an issue directly affecting the ability to secure tax-exempt financing)

All of these unknowns are basic to an informed decision as to whether to build such a facility.

As initially proposed, an outside, third party power producer would finance, design, construct, operate, and maintain the new plant on University land. The plant would generate electricity, steam, and hot and chilled water for heating and cooling. The University would lease the land to the developer and purchase the various energy commodities from the plant to meet its needs. At the end of a contract period, the University would have an option to acquire the plant.

In September 1993, the University entered into a development agreement with a contractor for the proposed plant. Construction for the first phase of the project, hot and chilled water facilities for the West Campus, started in January 1994.

In January 1994, the Board authorized the Interim President to sign the various agreements which would document and finalize the proposed cogeneration project. In February, the Board designated three individuals as interim directors for the nonprofit corporation which would own the plant. Various individual members of the Board and executive management, however, began asking questions about the economic viability of the project, and satisfactory answers to their questions were not found. At this time, the System and the University had new individuals in leadership positions who did not have familiarity with the cogeneration project.

The Interim President of the University asked the System's Vice Chancellor for Finance and Operations to review and evaluate the project. In March 1994 an outside firm was engaged to review the evaluation process the University had used in evaluating proposals. The Vice Chancellor for Finance and Operations also performed a separate evaluation of the project. Using his independent assessment of the evaluation of the project, together with the report issued by the outside consulting

firm evaluating the project, the Vice Chancellor recommended that the University discontinue further negotiations with the developer. On June 17, the new President notified the developer that he was exercising the University's option to terminate the development agreement, and the Board of Regents confirmed his action on July 22. The System then asked the System and University internal auditors to review the project.

Had the new leadership not elected to have the project independently evaluated, the project may have proceeded at great financial risk to the University. System Administration is currently involved in a dispute with the developer, who claims to have incurred \$59 million in costs on the project, as well as a dispute over nearly \$1 million in unpaid billings from the primary consultant used by the University throughout the process.

Management of The Project Was a "Departure From Business As Usual"

The term "departure from business as usual" was used by TAMU officials managing the project to describe and justify their actions. It appears to have been a euphemism for the circumvention of normal channels, policies, and procedures in the name of expediency. Throughout the project, correspondence among various parties reflected a sense of urgency and the need to expedite matters as quickly as possible to meet a final deadline of August 1, 1995. This compressed schedule likely contributed to a number of questionable decisions.

From the beginning, the project was handled by a small group, including the former Chairman of the Board of Regents, the former Vice President for Finance and Administration, and the former Director of the Physical Plant. Neither the Board of Regents as a whole, the Chancellor, the President, nor various System functions were fully involved in the decision-making process.

The Board's Oversight of the Project Was Limited

The Board's oversight of the project appears to have been minimal until their approval of the development agreement on September 17, 1993. The Board's Facilities Planning and Construction Committee also provided no oversight for the project. When the Board's involvement and support were solicited, the information received in briefings was limited and, at times, inaccurate.

In contrast, the former Chairman was personally involved in conversations or activities concerning the project as early as June 1992 and continued to be involved on an ongoing basis. His advice was sought in the hiring of consultants for the project, and one law firm was contracted through the consulting company after the former Chairman brought the firm to management's attention. A key meeting on the project was held in February 1993 in the Dallas office of the former Chairman's law firm. The former Vice President for Finance and Administration and the former Director of the Physical Plant believed they were given sufficient authority to

proceed; however, this was not a meeting of the Board. The former Chairman was called upon to intercede when negotiations with the developer reached an impasse, and activities related to the project were postponed at times to accommodate his schedule.

In January 1992, the Board received a report in closed session from representatives of a consulting firm who recommended that the University pursue a joint course of action regarding its future power supply. They recommended further analysis of the feasibility of either having a third party build a plant on the West Campus or entering into a twenty-year power supply contract with a municipal power agency, questioning whether new cogeneration facilities could be put into operation by the time they were needed. Of the two options recommended, construction of a new facility carried greater associated risks. Subsequent to this presentation, it appears that management pursued the construction of a new plant without further consideration of the second option.

The Board did not receive any information concerning the cogeneration project until it was introduced to consultants for the project in a closed session in March 1993. By this time, the project team had already been evaluating finalists' proposals for nearly two months. The Board did not receive a report on the project in an open meeting until its special meeting in Temple on May 13, 1993, only two weeks before the University announced it would begin negotiations with the developer who eventually was chosen for the project.

Subsequently, the Board would receive several briefings in executive session. Board minutes indicate that these presentations concerned the University's progress in obtaining a contractor for the project and that the briefings were held in closed session to protect the confidentiality of finalist's proposals. The Board would be called on to authorize the negotiation of several additional agreements and to name an interim board of directors for a nonprofit corporation which would have overall responsibility for the plant; however, the minutes indicate minimal discussion of these items. Whether it was the Board's intent or not, management on at least one occasion interpreted the Board's silence on an issue as tacit approval of management's intent.

From the minutes of the board meeting in Temple on May 13, 1993, where they received their first public briefing on the project, it appears that the former Director of the Physical Plant misrepresented the findings of a 1990 consultant's report as it related to third-party development. According to the minutes, he stated that the consultants had "reached the conclusion that the clear economic winner was to construct a new cogeneration plant on the TAMU campus" and that the dollar cost for the new plant would be approximately \$75 million.

An examination of the consultant's report, however, indicates that their study focused only on the feasibility of third-party operation of the existing power plant under various arrangements. Constructing a new plant was never proposed: the consultants simply recommended the installation of an additional generator as an expansion of the University's existing plant. Moreover, they concluded that there was a substantial economic disadvantage to third-party operation and recommended that the University continue to operate the central plant itself.

The Board would continue to receive limited or inaccurate information about the project on a number of other occasions, including their September 1993 board meeting. At that meeting, before the Board authorized the signing of the Development Agreement, the former Chairman read a public statement requesting that questions and responses be limited to protect the finalists in the negotiations. Board minutes indicate limited discussion prior to the Board's vote.

During the meeting, the former Director of the Physical Plant told the Board that the winning finalist's proposal met all of the University's energy needs through the year 2012. A later consultant's report, however, found that the project team did not focus on the finalists' ability to meet the energy requirements and that, with the developer's proposal, the University's power requirements would begin to exceed the cogeneration plant's peak capability in the year 2007. According to their report, the developer did not address the need for supplemental power in later years.

There is no record of any formal board action relating to the project until September 17, 1993, when the Board authorized the President to execute a development agreement with the contractor to have the plant built. By this time, activities relating to the project had been underway for over a year: consultants had been hired, two Requests for Proposals had been issued, responses had been received and evaluated, and negotiations had been conducted with finalists for three and one-half months.

Other Parties Were Left Out of the Process

The project team was limited to a handful of individuals, primarily at the University, leaving System officials and functions, such as Finance and Facilities Planning and Construction, out of the process or relegated to a marginal role. The project team was secretive in its activities, operating out of an office at the University's old airport. The team reportedly acted in this manner to protect the confidentiality of ongoing negotiations; however, by operating in such a manner, they also avoided potential oversight and accountability and ultimately failed to capitalize on available System resources which might have helped to ensure the project's success.

The System's Facilities Planning and Construction Division, which could have contributed significant management experience to the project, was bypassed. However, in June 1994 they were called upon to take over and complete the project's first phase after the project was discontinued.

In a memo dated May 10, 1993, the former Chancellor, who had an engineering background, raised concerns regarding the proposed plant which were never answered to his satisfaction. He stated that he found it hard to believe that long-term energy demand would grow at the projected rate for the new plant given an enrollment cap, the limited physical plant growth needed to handle that level of enrollment, and a likely increase in the costs of energy, creating strong incentives for conservation. He also expressed concern that the University be protected from being required to purchase more energy than it could use. In response, the former Director of the Physical Plant, in a memo dated June 29, 1993, to the former Vice President for Finance and Administration, cited a contemplated excess power sales agreement

(which was never completed nor executed) as the mechanism for adjusting for variances in energy needs, further stating that "no one can accurately predict future energy needs."

As noted below, the Office of General Counsel was not consulted with respect to all contracts and tasking letters relating to the project. Finally, the System's financial staff and outside advisors were left out of the process, with different advisors being retained specifically for the project.

The University's Relationship With Its Consultants

In October 1992, the University entered into a relationship with a company which served as the primary consultant to the University on the project. According to a June 1994 report by another firm, the company had a major role in virtually all activities and decisions relating to the project. While neither of the principals in the company is an engineer, they were engaged, through a series of professional and technical services agreements, for engineering services. Ultimately, however, less than eight percent of the company's total billings were for engineering services. Legal services in excess of \$600,000 were also obtained through the consultants without obtaining prior written approval from the Attorney General, as required by state statute and System policy. The University originally estimated that the services of these consultants would cost \$250,000; ultimately, the company billed in excess of \$2 million.

The company was recommended by an outside attorney who performed legal work associated with the University's spot acquisitions of natural gas. The attorney shortly thereafter became a principal member of the project team as a senior representative of the consulting company; he later became a full partner in the consulting company with 50 percent ownership. His law firm also performed services which, according to a letter from the firm, were billed through the consulting company. These services were performed in the absence of a signed retainer agreement. An attorney in the Office of General Counsel later wrote in August 1993 that he was unable to find evidence that the University had ever attempted to obtain prior written approval from the Attorney General.

The president of the company is an accountant by profession. Both he and his partner later stressed that they were acting as consultants, and not in their professional capacities as an accountant and an attorney, in their roles on the project. For consulting contracts in excess of \$10,000, state statute and System policy require that notifications be sent to the Governor's Office of Budget and Planning, the Legislative Budget Board, and the Secretary of State, and such contracts must be awarded through a bid process. University management did not send out a Request for Proposals with respect to the contract and failed to make any of the required notifications.

Under the Professional Services Procurement Act and System policy, contracts for certain types of professional services, including accounting and professional engineering, are exempt from the notification, publication, finding of fact, and final reporting requirements which apply to consulting contracts. However, services

provided by such professionals which are outside the scope of the profession for which they are registered or otherwise licensed are not considered professional services for the purposes of the Act; they are governed by the requirements for consultant contracts. The University's agreements with the company stipulated that the company would provide engineering-related services. Neither of the principals in the company was an engineer, nor was the company an engineering firm. Their billed time and overhead, however, would comprise 62 percent (\$1,256,891) of total billings. All engineering services were subcontracted by the company, and the engineering services provided comprised less than eight percent (\$150,299) of the company's billings.

Two law firms were also subcontracted and billed through the company. Invoices submitted for these firms' services comprised 30 percent (\$611,577) of the company's eventual billings. The University did not obtain prior written approval from the Attorney General for the services of either of these firms.

Except for its initial \$25,000 contract, the University's contracts with the consultants placed no overall dollar limits on the consulting services to be provided. The contracts only stipulated rates at which services would be rendered. Written tasking letters were to be used to request specific services and to set specific dollar limits, or "levels of effort," for those services. Additional services could thus be requested through successive tasking letters, without any requirement for a higher level of review and approval once the cumulative dollar amount reached a given threshold.

Additionally, all subsequent contracts provided for the company to bill the University for an "indirect burden" over and above its hourly professional and technical fees and expenses. This "indirect burden" was also added to the billings of the company's subcontractors and ultimately amounted to 25 percent of later direct billings, for a total of nearly \$400,000. A surcharge of this magnitude appears very unusual.

Although the Office of General Counsel was asked to review the first two contracts with the consultants, there is no indication that they reviewed a third contract, which was never signed, or a fourth contract, which was not signed by the University until nearly three and one-half months after its effective date. It also appears that they saw few of the tasking letters. A significant portion of the consulting services would eventually be rendered solely on the basis of management's verbal instructions, without additional written support, and, as noted below, services would be rendered during one period of nearly seven and one-half months in the absence of a contract signed by both parties. The absence of a contract was acknowledged in writing by University management and the consultants on at least four occasions during this period. Billings for this period totaled approximately \$1 million, or half of the eventual total billings.

The consultants helped negotiate the development agreement for the cogeneration plant. As part of this agreement, provision was made for the developer to reimburse the University for its predevelopment costs, including consultant costs, up to a limit of \$1.25 million.

Prior to the signing of this agreement, however, the former Director of the Physical Plant advised the developer's project manager that they should anticipate future billings from the consultants for the University's additional costs. The University would review and forward the statements to the developer for direct payment to the consultants. This was contrary to the payment arrangement stipulated in the development agreement. Nonetheless, the developer made a direct payment of \$301,028 to the consultants for costs incurred prior to the signing of the development agreement, and two subsequent invoices would be paid directly to the consultants as well. When the first of those two invoices was submitted, the former Director of the Physical Plant recommended its direct payment by the developer "since we currently do not have a contract with [the consultants]."

In total, \$645,160 of the \$1,051,614 eventually paid to the consultants was paid directly by the developer. As noted above, during much of this period, there was no contract between the University and the consultants. Moreover, the final contract between the University and the consultants stipulated that the University could either pay the consultants or, at its election, have the developer pay the consultants. The absence of a contract between the University and the consultants during much of this period, in addition to their direct payment by the developer, may raise a question of who the consultants were working for during this period and whose interests they were serving. Additionally, now that the developer has been released from the project, there is a likelihood that they will expect to be reimbursed by the University for the predevelopment costs paid on the University's behalf.

The consultants billed the University for negotiating a natural gas transportation cost agreement with a company owning the pipelines on campus. Although not related to the cogeneration plant, University management included these billings as part of the overall project costs. Had the project not been terminated, the developer may have found itself subsidizing the costs of these negotiations with its competitor plus a 25 percent "indirect burden."

Throughout the life of the project, consulting budget overages were continually problematic, more so because University management had no funds at their disposal which had been specifically identified for this purpose. Management hoped to ultimately recover their consultant costs through the reimbursement agreement with the developer.

At the outset of the project, University management estimated their consulting costs at \$250,000. On January 20, 1993, management learned these costs might approach \$600,000. In March, the former Vice President for Finance and Administration wrote the consulting company, expressing concern over hours accrued by the company in excess of those authorized and stating that they should institute controls to comply with the provisions of the contract. By the time the development agreement was signed, in the fall of 1993, provision had been made for a budget of \$1.25 million by virtue of the reimbursement agreement with the developer. However, in November, the company president wrote the former Director of the Physical Plant projecting an overage of \$275,895 from that amount.

On March 22, 1994, the company president wrote again, stating his understanding that the University and the developer had provided a mechanism to increase the budget to \$1.9 million. That agreement was never finalized; nevertheless, in his letter, the company president notified the University that cumulative project costs had exceeded this figure as well.

During the time the consultants were working for the University, overages were variously attributed to "the complexity of the evaluation and the high value of the project," "complexities and variables of the evaluation not ascertainable at the time the staffing plan was formulated," the recovery of costs "not ascertainable at the time the development agreement was signed," or to the consultants' participation in various activities outside the scope of the various tasking letters. Ultimately, their total billings to the University amounted to \$2,025,034.

The Evaluation and Negotiation Processes

Another area in which management departed from "business as usual" involved the means by which it selected a developer to build the proposed plant. Rather than commission and approve a design for the facility, then solicit bids from contractors and award a contract based on the best bid received, the University issued an initial Request for Proposals (RFP-I), soliciting Statements of Qualifications and Experience from potential candidates. The firm hired to assist in preparing RFP-I would later become the subcontractor for the winning finalist. University management engaged this firm to assist with RFP-I in June 1992, but a handwritten note from the former Director of the Physical Plant indicates that by October 5 management still had not obtained a signed contract for these services.

Responses to RFP-I were evaluated to identify viable contenders for the project, and a second Request for Proposals (RFP-II) was then issued, with three subsequent clarifying addenda. RFP-II identified the University's energy requirements and invited the remaining candidates to submit proposals to meet those needs. Responses were evaluated based on criteria developed by the University's project team, and on the basis of this evaluation, one finalist was selected with whom to conduct negotiations. According to the process developed by the team, if a satisfactory agreement was not reached within 45 days, the University would open negotiations with the next highest ranked finalist, and the process would continue sequentially through the candidates until a satisfactory contract was negotiated.

A finalist was chosen for negotiations in May 1993, and negotiations began on June 1. After the negotiation period ended without a satisfactory agreement, the University departed from its stated rules by continuing negotiations with the first finalist while entering into parallel negotiations with the second-ranked finalist. Internal correspondence between members of the project team suggests that the second finalist may have been brought in simply to furnish leverage in dealing with the first finalist, who eventually was selected for the project.

Both parties submitted final development offers on August 23, 1993, although clarifications and modifications continued to be sent to the University until at least

September 8. The University entered into a two phase contractual arrangement with the first finalist on September 27, 1993. The development agreement provided for the completion of the first phase (installation of a capability to provide hot and chilled water to meet near-term needs) by September 1, 1994, and completion of Phase II (the cogeneration facilities) by August 1, 1995.

An outside firm's report, released in June 1994, found flaws in the basic assumptions used to establish the feasibility of going ahead with a cogeneration plant as well as the evaluation and comparison of the different proposals. Among their concerns were the following:

- The firm found that the University's energy requirements forecast neglected a number of key factors driving energy requirements such as square footage, end use, building age and insulation levels, and actual growth. Instead, requirements were estimated by extrapolating an historical trend line, with a minor adjustment for construction taking place during 1993 and 1994. The base period from which these requirements were extrapolated included the greatest growth in the University's history, from 10,000 students to 40,000 students. No consideration was given to the cap on student population growth, and no explicit consideration was given to the University's strategic plans to expand research and service. Errors in the forecast of energy requirements could lead to an inability to meet demands due to inadequate capacity, or to inefficiency and wasteful expenditures due to excess capacity.
- The treatment of reserve energy requirements resulted in the overstatement of energy requirements by 15 percent in the base case. Purchased power energy requirements were also overstated, especially in the early years.
- The University's base case did not include the costs of hot and chilled water. The dollar impact of this omission was of sufficient magnitude to reduce the benefits of cogeneration to the University.
- No sensitivity analysis was performed to determine the effect changing gas prices would have on the desirability of building a plant.
- The cost of purchased power was assumed to rise by almost six percent per year, but this assumption was not tested. The evaluation team also reportedly ignored lower assumed rates (a 3.5 percent case and a 5.2 percent case) which were put forth by the firm who gave the report to the Board in January 1992. According to the consultants, "a lower growth in the cost of purchased power could call the advisability of building any cogeneration facility into question."
- The firm found that the evaluation team had not given adequate attention to the importance of a back-up power supply, and their estimate for the price of supplemental and back-up power was questionable.
- The evaluation team's analysis did not consider how the changing structure and regulations of the electric utility industry could affect the purchase power

option, as well as the associated risk that long-term contracts for cogeneration could turn out to be uneconomical.

The secrecy in which the evaluation and negotiations were handled make it difficult to understand fully how the University came to select the developer with whom the development agreement was signed. However, some observations can be made, as noted below:

- The outside firm's report cited the advantage the first finalist had from knowledge gained in the first 45 days of exclusive negotiations with the project team. Because time spent with the various finalists differed considerably, so did their knowledge of the University's concerns and changing thermal needs. The consultants suggested that it would have been more fair to the finalists, and possibly more beneficial to the University, to have opened negotiations up to all three finalists from the outset; parallel negotiations with all three finalists could have produced better offers.
- The third finalist attempted to submit an amended proposal late in the process and was rejected, although the project team had previously changed the rules for the evaluation and negotiation process. Additionally, the other two finalists had been allowed to change their proposals significantly in some respects. The firm's report noted that it may have been to the University's benefit to have considered the third finalist's late proposal.
- The lack of specificity in RFP-II resulted in responses from finalists which were not directly comparable. RFP-II specified two basic needs for power and steam. However, the proposals received contained a number of "side benefits" which were not uniform among the competitors. The varying nature of the proposals resulted in a lack of direct comparability. The difficulty in assigning appropriate weights to some of the features included therein gave rise to a number of opportunities for subjective judgments during the evaluation process. One engineer briefly involved in the process described the evaluation as one of "comparing apples to oranges."

Additional Risks Associated With The Project

As stated by management throughout the life of the project, one of the primary motives behind their desire for third-party development was the transfer of all risks associated with the project. This was also stated in the Final Proposal Evaluation Report and Recommendation. The report concluded that the assumption of the underlying risks by both finalists in the negotiations effectively transferred risks from the University to the project.

However, the June 1994 report prepared by an outside firm hired to review the cogeneration project found that the project team's evaluation matrix did not properly address issues of substantial risk to the University in addition to the issues raised above.

Management had stated its concerns that the University not become committed to buying more energy than needed, especially under a "take or pay" scenario. However, the outside firm's report found that the team's evaluation matrix did not adequately address the need to assure a buyer of excess power. The developer's proposal required purchases at a 70 percent capacity factor. As noted previously, the University's forecast of energy requirements had been called into question; additionally, the non-profit corporation may have been limited by tax rules to selling only 5 to 10 percent of the total energy produced in order to maintain the project's tax-exempt status. As of the date the project was terminated, the need for a buyer of excess power had not been addressed.

The outside firm's report also found that the project team's evaluation matrix did not adequately address the need to assure a supplier of back-up power. As of the date of the report, this problem also had yet to be resolved.

Although the team was aware of management's intent regarding the transfer of risk, they recommended entering into the development agreement. The University's consultants were aware of the risks inherent in doing so. In a letter dated October 11, 1993, to the former Director of the Physical Plant, the partners in the consulting company wrote that "by virtue of the University's development agreement with [the developer], the University assumed substantial risk associated with the Project's excess power sales and standby power arrangements." Their company had been instrumental in negotiating this agreement.

The outside firm's report found that the team's evaluation matrix did not adequately address the need to assure a bond issuer for the project. Under the contemplated arrangement, an industrial development corporation would issue tax-exempt bonds and loan the proceeds to the nonprofit corporation as owner of the project. The nonprofit corporation would use the proceeds for constructing the project; debt service on the bonds would be paid by the University through its payments for purchased energy. The arrangement required that the Attorney General approve the tax-exempt revenue bonds and that the Legislature make available sufficient appropriations to purchase the energy produced by the project.

The outside firm found no evidence that the ability or inability of a finalist to secure a bond issuer, and its effect on project viability, was reflected in the evaluation team's scoring of proposals. Neither of the two finalists seriously considered had taken the necessary steps to secure the cooperation of a qualifying governmental bond issuing agency, and the project team never requested that they obtain a "warranty" for an issuer. At the time the project was terminated, a bond issuer had yet to be found. The outside firm's report indicated that the inability to secure a bond issuer was contributing to the virtual stoppage of the project at that time. Correspondence between the developer and the University in February 1994 discussed the difficulty inherent in securing a bond issuer given the lack of local support for the project as it was being conducted. Additionally, there was no guarantee that sufficient funding would be forthcoming from the Legislature; in fact, in fiscal year 1994, the University's utility appropriations failed to fully fund its energy expenditures.

The University's Relations with the Developer

Certain documents and events suggest that some members of the project team may have had a partiality towards the developer who was ultimately selected for the project. In January 1993, eleven days before the deadline for submission of proposals, the former Director of the Physical Plant sent outlines of four of the developer's potential financing options to the University's bond counsel for review in anticipation that one of the options would be included in the developer's proposal. When the proposal was received, the financing mechanism contemplated was not feasible. The second finalist's proposed financing mechanism was feasible and attractive. Although negotiations were ostensibly confidential, the second finalist's proposed financing mechanism was eventually incorporated into the winning developer's final proposal.

It appears that the developer selected was given a preferential position throughout the negotiation process. In an internal memo, the former Director of the Physical Plant recommended contingent approval of contractual documents for the developer to proceed only 16 days into the negotiations. Even after negotiations with the developer reached a stalemate, the developer was allowed to continue in the parallel negotiation process, contrary to the rules originally promulgated.

On August 27, 1993, although two members of the project team still had significant concerns with the technical aspects of the developer's proposal, the head of the technical review team wrote to the former Director of the Physical Plant, stating that "I want [the developer] to get the job, because I know and trust and have confidence in [the developer's proposed subcontractor], and that's why I worked so hard to get them into the project to start with . . . we need to start playing hard ball with them . . . and keep [the second finalist] in the running as a lever if nothing else. It may not be pristinely fair, but it's in the best interest of TAMU. . ."

Four days later, the former Vice President for Finance and Administration sent the President the agenda item for approval of the development agreement, telling him "this will be acted on at the September Board of Regents meeting." The Board authorized the signing of the development agreement on September 17.

As noted previously, the project team did not focus on finalists' ability to meet the University's energy requirements. According to the outside firm's report, the developer's proposal did not meet the University's energy requirements as stated in RFP-II, and, unlike the other two finalists, the developer did not address the need for supplemental power in later years, "nor did they offer a signed agreement, or even a letter of intent suggesting the availability of a supply for supplemental power."

Even after the development agreement was signed, management continued to be secretive with information regarding the evaluation and negotiation process. In the spring of 1994 the City of College Station, which had been a third finalist, wrote the University raising a number of questions and citing a number of perceived flaws in the process. The developer was allowed to participate in the University's responses to the City. Additionally, in preparing these responses, the president of the consulting company was instructed to use only information available as of May 1993, leading up

to the selection of the first finalist for negotiations. Information from the three and one-half months of negotiations was omitted.

As noted previously, construction began on campus in January 1994, even though the developer had not secured financing, and a ground lease between the University and the developer had not been signed. As of the date the project was terminated, these issues had yet to be resolved; nonetheless, by that time the developer claimed to have incurred approximately \$59 million in project-related costs. The System and the developer are currently attempting to resolve this matter.

Copies of this report have been distributed to the following:

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Honorable Bob Bullock, Lieutenant Governor, Vice Chair
Senator John Montford, Chair, Senate Finance Committee
Senator Kenneth Armbrister, Chair, Senate State Affairs Committee
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