

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS

IA # 03-16 – INTERNAL AUDIT REPORT OVER REVENUE

REPORT DATE: JULY 8, 2016

ISSUED: AUGUST 15, 2016

TABLE OF CONTENTS

	Page
INTERNAL AUDIT REPORT TRANSMITTAL LETTER TO THE OVERSIGHT COMMITTEE.....	1
BACKGROUND	2
AUDIT OBJECTIVE AND SCOPE	3
EXECUTIVE SUMMARY	4
CONCLUSION	4
DETAILED PROCEDURES PERFORMED, FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSE.....	5
Objective A: Design of Internal Controls	6
Objective B: Effectiveness of Internal Controls	9
APPENDIX	10



The Oversight Committee
Cancer Prevention and Research Institute of Texas
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This report presents the results of the internal audit procedures performed for the Cancer Prevention and Research Institute of Texas (the Institute) during the period June 20, 2016 through July 8, 2016 relating to the Institute's Revenue process.

The objectives of this internal audit were to evaluate the design and effectiveness of CPRIT's Revenue processes. The objectives were organized as follows:

- A. Verify that internal controls over revenue receipt, recording, reporting and tracking are designed to ensure the effective management of the process and address all key risks.
- B. Ensure that the controls in place over high-risk processes are operating effectively to ensure that revenue is appropriately recorded, monitored, and reported.

To accomplish these objectives, we conducted interviews with key personnel responsible for the Revenue process. We also reviewed documentation and performed specific testing procedures to assess controls. Procedures were performed at the Cancer Prevention and Research Institute of Texas office and were completed on July 8, 2016.

The following report summarizes the findings identified, risks to the organization, recommendations for improvement and management's responses.

Weaver and Tidwell, L.L.P.

WEAVER AND TIDWELL, L.L.P.
Austin, Texas
August 15, 2016

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
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BACKGROUND

The Cancer Prevention and Research Institute of Texas (CPRIT) was established in 2007 as a result of a Texas constitutional amendment. CPRIT's goal is to expedite innovation in academic and product development cancer research, and to enhance access to evidence-based prevention programs throughout the state. CPRIT is funded primarily through General Obligation Bonds proceeds appropriated by the Legislature. Under the guidance of its governing body, the Oversight Committee, CPRIT accepts applications and awards grants for a wide variety of cancer-related research and for the delivery of cancer prevention programs and services by public and private entities located in Texas. All CPRIT-funded research will be conducted in state by Texas-based scientists and reflect CPRIT's mission to attract and expand the state's research capabilities and create high quality new jobs in Texas.

In addition to proceeds from the issuance of general obligation bonds, the agency receives revenue from the sale of specialty license plates, product development grant applications, conference registration fees, and revenue sharing obligations from grantees. The typical annual funding is available as follows:

- Appropriated Funds:
 - \$300,000,000 from General Obligation Bonds
 - \$15,000 appropriated fee receipts from License Plate Sales, estimated based on actual sales volume
 - \$200,000 appropriated fee receipts from Conference Registration Fees biennially, estimated based on conference attendance
 - \$40,000 from Product Development Grant Application fees, estimated based on application volume
- Unappropriated Funds
 - Between \$10,000 and \$800,000 from Revenue Sharing obligations, historically averaging \$60,000 annually
 - Less than \$100 in donations

On a biennial basis, the agency is required to submit the Legislative Appropriations Request to the Legislative Budget Board in order to secure funding for the following two fiscal years. On a quarterly basis, a request for financing must be submitted to and approved by the Bond Review Board to authorize the Texas Public Finance Authority to issue general obligation bonds for CPRIT. The Chief Operating Officer is responsible for ensuring that bond proceeds are requested and received timely and accurately. CPRIT's Accountant is responsible for tracking, recording, and reconciling revenue.

Grantees are contractually obligated to share a portion of revenue generated from projects funded by CPRIT grants. To date, most of the opportunity for revenue sharing is associated with product development research grants, which are focused on generating new oncology drugs, diagnostics, or medical devices. The product development cycle for a cancer drug is typically 10 to 12 years and consists of initial research, formulation, preclinical trials, and multiple phases of clinical trials and regulatory approval. The drug development process costs approximately \$2 billion per drug. The majority of CPRIT funding is used in preclinical and early clinical stages and occurs between years four and seven of the product development cycle. As a result, it may take several years from the closeout of a grant until any revenue is generated by the grantee and shared with CPRIT. Further, on a per contract basis, the likelihood of revenue sharing obligations occurring is small since only about one out of 20 cancer drug advances to the revenue producing stage. A smaller portion of CPRIT's product development research grants involve medical device research, which has a life cycle between two and three years. These grant award amounts are generally smaller and have a lower revenue sharing payout when they are successful, although they have a higher chance of success.

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

AUDIT OBJECTIVE AND SCOPE

The audit focused on the process in place over the receipt, recording, reporting and tracking of revenue at the Cancer Prevention Research Institute of Texas (CPRIT). We reviewed the procedures for appropriate risk and regulatory coverage and compliance. Key functions and sub-processes within the Revenue process that were reviewed include:

- General Obligations Bonds
- License Plate Fees
- Grant Application Fees
- Revenue Sharing
- Other Revenue Sources

The audit did not include an evaluation of the future state of procedures and controls. The focus of our evaluation was on reoccurring procedures that were in place throughout the coverage period and are anticipated to remain in place in the future. Additionally the audit did not include budgeting or budget monitoring procedures.

Our procedures were designed to ensure relevant risks are covered and verified the following:

- Funding sources are identified in a timely manner
- Legislative Appropriations Requests are completed accurately and timely
- Receipt of funds is monitored and recorded accurately
- Funding sources are recorded accurately and timely
- Applications and registration fees are appropriately identified, assessed, and recorded
- Revenue sharing obligations are identified and collected
- Bond proceeds are timely and accurate

The objectives of this internal audit were as follows:

- A. Verify that internal controls over revenue receipt, recording, reporting and tracking are designed to ensure the effective management of the process and address all key risks.
- B. Ensure that the controls in place over high-risk processes are operating effectively to ensure that revenue is appropriately recorded, monitored, and reported.

Our procedures included interviewing key personnel within Financial Operations to gain an understanding of the current processes in place, examining existing documentation, evaluating the internal controls over the process, and testing the effectiveness of the controls in place. We evaluated the existing policies, procedures and processes in their current state. Our coverage period was from September 1, 2014, through May 31, 2016.

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

EXECUTIVE SUMMARY

Through our interviews, evaluation of internal control design and testing of transactions, we identified two findings. The listing of findings include those items that have been identified and are considered to be non-compliance issues with documented CPRIT policies and procedures, rules and regulations required by law, or where there is a lack of procedures or internal controls in place to cover risks to CPRIT. These issues could have significant financial or operational implications.

A summary of our results, by audit objective, is provided in the table below. *See the Appendix for an overview of the Assessment and Risk Ratings.*

OVERALL ASSESSMENT	STRONG
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SCOPE AREA	RESULT	RATING
Objective A: Verify that internal controls over revenue receipt, recording, reporting and tracking are designed to ensure the effective management of the process and address all key risks.	We identified 18 controls to be in place in the process. There are opportunities to improve the process and control environment, including: <ul style="list-style-type: none"> • Identify and monitor revenue sharing obligations • Document the reconciliation of bond issuance proceeds 	STRONG
Objective B: Ensure that the controls in place over high-risk processes are operating effectively to ensure that revenue is appropriately recorded, monitored, and reported.	Controls in place were generally operating as designed. We identified the following opportunities for improvement: <ul style="list-style-type: none"> • Validate revenue sharing payments 	STRONG

CONCLUSION

Based on our evaluation, the Revenue process has procedures and controls in place to conduct effective management of the significant processes within CPRIT. However, we identified two opportunities to improve the processes and effectiveness of the controls within the Revenue process.

CPRIT should ensure that all potential revenue sharing obligations are properly identified, valued and monitored and that payments are made timely and accurately. In addition, CPRIT should ensure that bond issuance proceeds received by CPRIT agree to the amounts requested and formally document this reconciliation.

Internal Audit will conduct follow-up procedures to validate remediation efforts in Fiscal Year 2017.

**DETAILED PROCEDURES PERFORMED, FINDINGS,
RECOMMENDATIONS AND MANAGEMENT RESPONSE**

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

**DETAILED PROCEDURES PERFORMED, FINDINGS, RECOMMENDATIONS
AND MANAGEMENT RESPONSE**

Our procedures included interviewing key personnel responsible for the Revenue process to gain an understanding of the current processes in place, examining existing documentation, evaluating the internal controls over the process, and testing the effectiveness of the controls in place. We evaluated the existing policies, procedures and processes in their current state.

Objective A: Design of Internal Controls

Verify that internal controls over revenue receipt, recording, reporting and tracking are designed to ensure the effective management of the process and address all key risks.

1. Procedures Performed: We gained an understanding of the current Revenue processes by conducting interviews with key personnel; reviewing existing procedures, standardized forms and documents used by CPRIT's personnel; and assessing CPRIT's administrative rules to identify key controls. We examined the following sub-processes:

- Preparation and validation of bond requests for issuance
- Identification of fees, payments, and revenue sharing
- Legislative Appropriations Request
- Validation of receipt of funds
- Classification of funds
- Verification of funding availability
- Reconciliation of actual funds to appropriations

We evaluated the controls identified against expected controls to determine whether the identified procedures and internal controls are sufficiently designed to mitigate all critical risks associated with the Revenue process. We identified any unacceptable risk exposures due to control design inadequacy or any opportunities to strengthen the effectiveness and efficiency of the existing control design.

Results: We identified 18 controls in place over the sub-processes within the Revenue function. We identified two findings where improvements in the processes, policies, and procedures can be made.

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

Cancer Prevention and Research Institute of Texas Revenue - Control Design Evaluation		
Sub-Process	Identified Controls	Findings/ Observations
Preparation and Validation of Bond Requests for Issuance	3	
Identification of Fees, Payments, and Revenue Sharing	3	Finding 1
Legislative Appropriations Request	3	
Validation of Receipt of Funds	4	
Classification of Funds	2	
Verification of Funding Availability	1	
Reconciliation of Actual Funds to Appropriations	2	Finding 2
Total	18	2

Finding 1 – LOW – Monitoring of Revenue Sharing Obligations: CPRIT does not have procedures in place to proactively monitor triggering events that require grantee revenue sharing payments to occur. In addition, CPRIT does not have a process to validate that revenue sharing obligations are received. Revenue is recognized and recorded when revenue sharing checks are received from grantees. CPRIT received a total of \$98,074.07 in revenue sharing payments from grantees during the audit period of September 1, 2014, through May 31, 2016.

Revenue sharing is self-reported by grantees through submission of an annual Revenue Sharing Report in the CGMS system. Revenue Sharing Reports are reviewed and approved by Grant Accountants, but no analysis is performed on the self-reported revenue to determine whether it is accurately calculated and there is no tracking process to ensure revenue payments received match reported obligations.

CPRIT's grant compliance monitoring procedures do not include steps to review non-financial grantee reports, such as the Annual Progress Report and any required Tranche Report, to identify grantee revenue subject to revenue sharing requirements in the grant contract. CPRIT's compliance group performs onsite and desk reviews which include a review of a grantee's program income and reported revenue sharing, but they do not have a process to determine the existence of all obligations. Grantees are selected for review based on an annual risk assessment, and the likelihood for revenue sharing is not a component of the risk assessment.

For two revenue sharing payments totaling \$3,529 out of 10 payments that were tested, the grantee did not provide supporting documentation to evidence occurrence and validate that the shared revenues were accurately calculated.

Recommendation: CPRIT should ensure that all potential revenue sharing obligations are properly identified and tracked. Revenue sharing obligations, as of a triggering event, should be valued and monitored to ensure that payments are received timely and accurately.

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

CPRIT's grant compliance monitoring procedures could leverage the evaluation recently completed (July 2016) by the Chief Product Development Research Officer to actively monitor the status of product development grant recipients who are at or near the point of marketing a product and producing revenue. With the Chief Product Development Officer's input on the product market, the Chief Compliance Officer and his staff could incorporate this information into the grantee risk assessment used to develop the compliance monitoring plan each year.

For active grantees, the CPRIT compliance group could modify their onsite and desk review procedures to include a review of grantee income related to CPRIT grants to verify that revenue sharing obligations were properly self-reported and identify any that were not. These review procedures could include reviews of Annual Progress Reports and any required Tranche Reports to identify unreported revenue that is subject to revenue sharing. Additionally, CPRIT could verify that revenue sharing payments are calculated accurately based on contract requirements.

For grantees approaching the close of their grant, CPRIT could add procedural steps to the grant close-out process to determine the future opportunity for revenue sharing from the grantee's project (including derivative technologies of the product research). As part of these procedures, CPRIT could determine the necessity of continuing to actively monitor the grantee after the grant is closed. The attributes for determining whether future monitoring is warranted could be predefined and could include materiality, technical feasibility, or other predictive indicators based on input from the Chief Product Development Officer.

Finally, Grant Accountants could maintain a list of all grantees who report revenue sharing obligations in annual Revenue Sharing Reports. This list could be communicated to the Chief Compliance Officer and Accountant to ensure that all reported revenue obligations are received and recorded. The Accountant could monitor outstanding payments and communicate the status of the payments to the Chief Operating Officer and Chief Compliance Officer on a quarterly basis.

CPRIT Management Response: CPRIT management agrees that the agency needs to proactively monitor the revenue sharing obligations of its product development research grantees. Since spring 2016, the Chief Executive Officer, Deputy Executive Officer and General Counsel, Chief Product Development Officer, and Chief Operating Officer have explored the possibility of having another qualified state entity or third-party vendor with expertise in managing new technology start-up investment portfolios assist CPRIT with monitoring the revenue sharing obligations of both active and closed research grants versus building the infrastructure and expertise from scratch within the agency. The results of this exploration will inform CPRIT management how to most effectively incorporate and implement procedures and processes to verify grantee revenue sharing obligations. The final determination to move forward with a separate entity to actively monitor grantee revenue sharing obligations must be considered and approved by the Oversight Committee.

CPRIT has redesigned the Revenue Sharing form in the CPRIT Grants Management System (CGMS) including a required field for the payment calculation and information about when the payment has been or is anticipated to be made. The finance team will develop a process for Grant Accountants to maintain a comprehensive list of grants with reported revenue sharing from grantees and with a corresponding verification of the revenue payment amount and receipt confirmation by the Accountant in the document with corresponding internal notifications.

Responsible Party: Chief Executive Officer, Deputy Executive Officer and General Counsel, Chief Product Development Officer, Chief Operating Officer, and Chief Compliance Officer

Implementation Date: March 1, 2017

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

Finding 2 – LOW – Reconciliation of Bond Issuance Proceeds: CPRIT does not formally document the Accountant's reconciliation of bond issuance proceeds to ensure they are received by CPRIT and agree to the amounts requested. Receipts of bond issuance proceeds are informally monitored by the Accountant, but there is no documented evidence of reconciliation of the amounts received to the amounts requested.

Recommendation: CPRIT should ensure that bond issuance proceeds received by CPRIT agree to the amounts requested. When bond issuance proceeds are received, the Accountant should reconcile the amounts received listed on the USAS DAFR report to the amounts requested in the Disbursement Certificate. Any discrepancies should be followed up on in a timely manner.

CPRIT Management Response: CPRIT management agrees that the Accountant's reconciliation of bond proceed receipts from general obligation bond and commercial paper note issuances should be documented. The Accountant will begin documenting the reconciliation process with the next commercial paper issuance.

Responsible Party: Chief Operating Officer, Accountant

Implementation Date: September 1, 2016

Objective B: Effectiveness of Controls

Ensure that the controls in place over high-risk processes are operating effectively to ensure that revenue is appropriately recorded, monitored, and reported.

- 1. Procedures Performed:** We selected the last Legislative Appropriations Request that was submitted on August 4, 2014, for testing. We verified that the request was properly reviewed and approved for accuracy and completeness and that it was submitted in a timely manner.

Results: No findings identified.

- 2. Procedures Performed:** We selected a sample of 50 revenue transactions recorded during the scope period of June 1, 2014 – May 31, 2016 and verified the following:
 - Revenues were supported by actual occurrences
 - Revenues were accurately calculated and have proper supporting documentation
 - Revenues were accurately reconciled
 - Revenue sharing proceeds were identified and calculated accurately

Results: We identified two revenue sharing deposits did not have adequate supporting documentation to evidence occurrence and validate that the shared revenues were accurately calculated.

Finding 1 – LOW – Monitoring of Revenue Sharing Obligations

APPENDIX

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
ISSUED: AUGUST 15, 2016

The appendix defines the approach and classifications utilized by Internal Audit to assess the residual risk of the area under review, the priority of the findings identified, and the overall assessment of the procedures performed.

REPORT RATINGS

The report rating encompasses the entire scope of the engagement and expresses the aggregate impact of the exceptions identified during our test work on one or more of the following objectives:

- Operating or program objectives and goals conform with those of the agency
- Agency objectives and goals are being met
- The activity under review is functioning in a manner which ensures:
 - Reliability and integrity of financial and operational information
 - Effectiveness and efficiency of operations and programs
 - Safeguarding of assets
 - Compliance with laws, regulations, policies, procedures and contracts

The following ratings are used to articulate the overall magnitude of the impact on the established criteria:

Strong	The area under review meets the expected level. No high risk rated findings and only a few moderate or low findings were identified.
Satisfactory	The area under review does not consistently meet the expected level. Several findings were identified and require routine efforts to correct, but do not significantly impair the control environment.
Unsatisfactory	The area under review is weak and frequently falls below expected levels. Numerous findings were identified that require substantial effort to correct.

CANCER PREVENTION & RESEARCH INSTITUTE OF TEXAS
IA# 03-16 INTERNAL AUDIT REPORT OVER REVENUE
JULY 8, 2016
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RISK RATINGS

Residual risk is the risk derived from the environment after considering the mitigating effect of internal controls. The area under audit has been assessed from a residual risk level utilizing the following risk management classification system.

High

High risk findings have qualitative factors that include, but are not limited to:

- Events that threaten the agency's achievement of strategic objectives or continued existence
- Impact of the finding could be felt outside of the agency or beyond a single function or department
- Potential material impact to operations or the agency's finances
- Remediation requires significant involvement from senior agency management

Moderate

Moderate risk findings have qualitative factors that include, but are not limited to:

- Events that could threaten financial or operational objectives of the agency
- Impact could be felt outside of the agency or across more than one function of the agency
- Noticeable and possibly material impact to the operations or finances of the agency
- Remediation efforts that will require the direct involvement of functional leader(s)
- May require senior agency management to be updated

Low

Low risk findings have qualitative factors that include, but are not limited to:

- Events that do not directly threaten the agency's strategic priorities
- Impact is limited to a single function within the agency
- Minimal financial or operational impact to the organization
- Require functional leader(s) to be kept updated, or have other controls that help to mitigate the related risk