

# SUPPLEMENTAL MATERIALS

## AGENDA ITEM VI-C

Update on Compliance Monitoring and consideration of adopting the Negotiated Rulemaking Committee's recommendation relating to the compliance monitoring function at the THECB

Comments received during the public comment period via the *Texas Register* were submitted to the Negotiated Rulemaking Committee for response. The comments and the committee's responses, which received unanimous consensus, are included in the attached.

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### Update on Compliance Monitoring and consideration of adopting the Negotiated Rulemaking Committee's recommendation relating to the compliance monitoring function at the THECB

RECOMMENDATION: Adopt

#### Background Information:

Senate Bill 215 passed by the 83rd Texas Legislature requires the Texas Higher Education Coordinating Board to establish an agency-wide, risk-based compliance monitoring function for:

- 1) funds allocated by the Board to institutions of higher education, private or independent institutions of higher education, and other entities, including student financial assistance funds, academic support grants, and any other grants, to ensure that those funds are distributed in accordance with applicable law and board rule; and
- 2) data reported by institutions of higher education to the Board and used by the Board for funding or policymaking decisions, including data used for formula funding allocations, to ensure the data are reported accurately. The legislation also requires the Coordinating Board to establish rules governing the compliance monitoring function via the negotiated rulemaking process.

Negotiated rulemaking was used in the development of the proposed rules in accordance with Texas Government Code Chapter 2008, as well as, Senate Bill 215.

Specifically, the proposed rules require the Board to review a reasonable portion of the total funds allocated and data reported, after considering potential risks and the Board's resources, using various levels of monitoring. The proposed rules require the Board to consider certain factors in developing its risk-based approach, to train staff to monitor both funds and data, and require other program staff to coordinate with monitoring staff to identify risks and avoid duplication.

The proposed rules require the Board, if it determines that funds have been misused or misallocated, to present its determination to the institution's governing board and chief executive officer (or just the institution's chief executive officer if it is a private institution of higher education) and provide an opportunity for response from the institution. The proposed rules require the Board to report its determination, response from the institution, and any

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recommendations to the institution's governing board or chief executive officer, the Governor, and the Legislative Budget Board.

The proposed rules provide that if the Board determines that an institution included errors in its data reported for formula funding, for a public junior college, it may adjust appropriations made to the college to account for the corrected data. For a general academic teaching institution, medical and dental unit, or public technical institute, the proposed rules require the Board to calculate a revised appropriation amount and report that amount to the Governor, Legislative Budget Board, and Comptroller for consideration as the basis for budget execution or other appropriate action.

The proposed rules authorize the Board to partner with internal audit offices at institutions of higher education and requires the internal auditor at an institution to notify the Board of any audits it or other third-party auditor conducts involving funds administered by, or data reported to, the Board. The notification shall include a copy of the final audit report being sent to the Board's Director of Internal Audit within 30 days of the date such final audit reports are sent to the institution's governing board and/or chief executive officer, the Texas State Auditor's Office, the Governor's office, the Legislative Budget Board, or similar stakeholders. The proposed rules also require the Board, to the extent not prohibited by law or other external provision, to eliminate requirements of institutions to conduct audits of funds administered by the Board as defined in the proposed rules.

The proposed rules authorize the Board to seek technical assistance from the State Auditor in establishing the compliance monitoring function and allow the State Auditor to periodically audit the Board's compliance monitoring function. The proposed rules also define "desk review," "site visit," and "student financial assistance."

Mark Poehl, Director of Internal Audit and Compliance, will provide an update on the work of the Compliance Monitoring Office as well as an overview of the proposed rules.

Date approved by the Commissioner for publication in the *Texas Register*: November 22, 2013.

Date Published in the *Texas Register*: December 6, 2013.

The 30-day comment period with the *Texas Register* ends on: January 6, 2014.

The following comments were received:

**Comment:** Texas Tech University suggested one edit to the proposed rules, 19 TAC Section 1.13(b)(5):

(5) The annual compliance monitoring ~~audit~~ plan that results from the board's risk assessment shall be presented to the board's Agency Operations Committee each July, seeking approval of

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the plan for the following fiscal year. Significant changes to the annual plan that may occur during each fiscal year shall be presented for ratification at the next scheduled Agency Operations Committee meeting.

**Response:** The Negotiated Rulemaking Committee on Compliance Monitoring unanimously agreed to incorporate this change.

**Comment:** The Independent Colleges and Universities of Texas (ICUT) suggested that the following terms be defined in the proposed rules since they are used interchangeably throughout the rules: "risk assessment," "compliance monitoring," and "audit." ICUT further stated that some parts of the rules imply these three processes are different from each other and that what is found using one process may lead to another. Without definitions of the terms and additional clarity, ICUT felt (1) it will be difficult for institutions to determine what level of scrutiny they are under at any given time; (2) institutions will lack information they need to determine what their expectations for interaction with agency personnel should be; (3) such definitions will enable institutions to know what triggered a shift from one level of scrutiny to another in mid-review; and (4) This will also protect agency staff from appearing capricious as they perform these functions.

**Response:** The Negotiated Rulemaking Committee on Compliance Monitoring unanimously agreed not to incorporate this change for the following reasons:

1. The Proposed Rule 19 TAC Section 1.13 mirrors SB 215 in providing statutory boundaries for compliance monitoring. Section (b) of the Proposed Rule describes the twofold purpose of the compliance monitoring function as specified in SB 215. Section (b) further describes a range of compliance monitoring levels, from data checks to comprehensive audits including site visits. The Negotiated Rulemaking Committee for Compliance Monitoring further added at Section (b) that the audit methodology shall be commensurate with the assessed risk.
2. The companion document to the Proposed Rule - Internal Policies and Procedures for Compliance Monitoring, states at 3-5, "The Compliance Department...Performs work in accordance with generally accepted government auditing standards (GAGAS) promulgated by the Comptroller General of the United States." These standards specify that, except in cases involving fraud or the need for the procedures to be performed on a surprise basis, that auditors should communicate the objectives, scope and methodology of the engagement (see Government Auditing Standards, 6.47).
3. The Internal Policies and Procedures for Compliance Monitoring, states at 3-3-4 Pre-Planning and Administrative Work and 3-3-5 Planning Work that the pre-planning phase of the audit includes an Audit Notification Memo is sent to the institution's CEO and others as appropriate, outlining the preliminary scope and objectives of the engagement and the plans for an entrance conference. The entrance conference is further outlined, including "The entrance conference will be used to solicit any input from client/management that might affect the completion of the audit."

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4. Risk assessment is defined in the Internal Policies and Procedures for Compliance Monitoring, at 3-1 Risk Assessment. "Risk assessments are performed to develop the risk-based approach to compliance monitoring. Risk assessment is performed as specified in SB 215, 83rd Legislature Regular Session." Each risk factor mandated by SB 215 is listed in both the Internal Policies and Procedures for Compliance Monitoring, as well as in the Proposed Rule at Section (d).
5. The Internal Policies and Procedures for Compliance Monitoring, states at 4-2-1 Definition of a Performance Audit, "Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria."

Legal Review:

Approved by the Office of General Counsel \_\_\_\_\_ Date: \_\_\_\_\_

The amendments have been prepared in the following format:

- New language is in lowercase, underlined, and shaded.
- Deleted language is bracketed and struck through.
- When new language replaces deleted language, the new language precedes the deleted language.

## CHAPTER 1. Rules Relating to Compliance Monitoring

### SUBCHAPTER A. General Provisions

#### Section

- 1.1 Dates for Regular Quarterly Meetings of the Board
- 1.2 Authority of the Commissioner to Interpret Rules
- 1.3 Educational Data
- 1.4 Rules of Order
- 1.5 Coordinating Board Committees
- 1.6 Advisory Committees
- 1.7 Petition for the Adoption of Rules
- 1.8 Historically Underutilized Business (HUBs) Program
- 1.9 Training for Members of Governing Boards and Board Trustees
- 1.10 Administration of the Open Records Act
- 1.11 Protest Procedures for Resolving Vendor Protests Relating to Purchasing Issues
- 1.12 Foreign Travel
- 1.13 Internal Auditor and Compliance Monitoring
- 1.14 Negotiated Rulemaking
- 1.15 Authority of the Commissioner to Propose Board Rules
- 1.16 Contracts for Materials and Services
- 1.17 Authority of the Commissioner to Provide Direct Supervision of the Education Research Centers
- 1.18 Operation of Education Research Centers
- 1.19 Education and Training of Board Administrators and Employees

1.1 – 1.12 (No change)

1.13. Internal Auditor and Compliance Monitoring

(a) Internal Auditor.

(1) [(a)] The Board shall appoint an internal auditor.

(2) [(b)] The internal auditor shall report directly to the Board on all matters except for those administrative matters that require the decision of the Commissioner.

(3) [(c)] The Board shall receive the advice and counsel of the Commissioner regarding matters of termination, discipline, transfer, or reclassification or changes in powers, duties or responsibilities of the internal auditor.

(4) [(d)] The internal auditor shall develop an annual audit plan, conduct audits as specified in the audit plan and document deviations, and discuss audit reports with the Administration and Financial Planning Committee of the Board.

(5) [(e)] The internal auditor shall provide all audit reports directly to the Board.

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(b) Compliance Monitoring.

(1) Definitions. The following words and terms, when used in this rule, shall have the following meaning:

(A) Board – The Texas Higher Education Coordinating Board.

(B) Commissioner – the Commissioner of Higher Education, the Chief Executive Officer of the Board.

(C) Institution of Higher Education – defined in Texas Education Code, Section 61.003.

(D) Private or Independent Institution of Higher Education - defined in Texas Education Code, Section 61.003.

(E) Student Financial Assistance - includes grants, scholarships, loans, and work study.

(F) Desk review - an administrative review by the board that is based on information reported by an institution of higher education or private or independent institution of higher education, including supplemental information required by the board for the purposes of compliance monitoring, except that the term does not include information or accompanying notes gathered by the board during a site visit.

(G) Site visit - an announced or unannounced in-person visit by a representative of the board to an institution of higher education or private or independent institution of higher education for the purposes of compliance monitoring.

(2) Purpose. The purpose of the board's risk assessment process and compliance methodologies is to maximize the effectiveness of monitoring funds allocated by the board and data reported to the board. The agency-wide, risk-based compliance monitoring function is established for:

(A) funds allocated by the board to institutions of higher education, private or independent institutions of higher education, and other entities, including student financial assistance funds, academic support grants, and any other grants, to ensure that those funds are distributed in accordance with applicable law and board rule; and

(B) data reported by institutions of higher education to the board and used by the board for funding or policymaking decisions, including data used for formula funding allocations, to ensure the data are accurately and consistently reported.

(3) After considering potential risks and the board's resources, the board shall review a reasonable portion of the total funds allocated by the board and of data reported to the board. The board shall use various levels of monitoring, according to risk, ranging from checking reported data for errors and inconsistencies to conducting comprehensive audits, including site visits. Audit methodology shall be commensurate with the assessed risk.

(4) The board's risk-based approach shall be implemented to address the diversity of institutions of higher education and private or independent institutions of higher education in Texas. The board shall develop audit and compliance monitoring methodologies, such as Desk

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Reviews and data analysis, that are commensurate with assessed risk and that are reflective of institutional differences. The board's risk-based approach to compliance monitoring shall consider the following factors relating to an institution of higher education or private or independent institution of higher education:

(A) the amount of student financial assistance or grant funds allocated to the institution by the board;

(B) whether the institution is required to obtain and submit an independent audit;

(C) the institution's internal controls;

(D) the length of time since the institution's last desk review or site visit;

(E) past misuse of funds or misreported data by the institution;

(F) in regard to data verification, whether the data reported to the board by the institution is used for determining funding allocations; and

(G) other factors as considered appropriate by the board.

(5) The annual compliance **monitoring** audit plan that results from the board's risk assessment shall be presented to the board's Agency Operations Committee each July, seeking approval of the plan for the following fiscal year. Significant changes to the annual plan that may occur during each fiscal year shall be presented for ratification at the next scheduled Agency Operations Committee meeting.

(6) The board shall train compliance monitoring staff to ensure that the staff has the ability to monitor both funds compliance and data reporting accuracy. Program staff in other board divisions who conduct limited monitoring and contract administration shall coordinate with the compliance monitoring function to identify risks and avoid duplication.

(7) If the board determines through its compliance monitoring function that funds awarded by the board to an institution of higher education or private or independent institution of higher education have been misused or misallocated by the institution, the board shall present its determination to the institution's governing board and chief executive officer, or to the institution's chief executive officer if the institution is a private or independent institution of higher education, and provide an opportunity for a response from the institution. Following the opportunity for response, the board shall report its determination and the institution's response, together with any recommendations, to the institution's governing board or chief executive officer, as applicable, the governor, and the Legislative Budget Board.

(8) If the board determines through its compliance monitoring function that an institution of higher education has included errors in the institution's data reported for formula funding, the board:

(A) for a public junior college, may adjust the appropriations made to the college for a fiscal year as necessary to account for the corrected data; and



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(B) for a general academic teaching institution, a medical and dental unit, or a public technical institute, shall calculate a revised appropriation amount for the applicable fiscal year based on the corrected data and report that revised amount to the governor and Legislative Budget Board for consideration as the basis for budget execution or other appropriate action, and to the comptroller.

(9) To the extent not prohibited by law or other external provision, the board shall eliminate requirements of institutions to conduct audits of funds administered by the board as defined in section (2). In conducting the compliance monitoring function, the board may partner with internal audit offices at institutions of higher education and private or independent institutions of higher education, as institutional resources allow, to examine the institutions' use of funds allocated by, and data reported to, the board. To avoid duplication of effort and assist the board in identifying risk, an internal auditor at an institution shall notify the board of any audits conducted by the auditor or other third party auditors involving funds administered by the board or data reported to the board, as defined in (2) of this section. Such notification shall include a copy of the final audit report being sent to the board's Director, Internal Audit and Compliance, within 30 days of the date such final audit reports are sent to the institution's governing board and/or chief executive officer, the Texas State Auditor's Office, the Governor's Office, the Legislative Budget Board, or other similar stakeholders. The final audit report should be addressed to: Texas Higher Education Coordinating Board, Director, Internal Audit and Compliance. 1200 East Anderson Lane, Austin, TX 78752.

(10) Private or independent institutions of higher education must provide to the board the institution's external audit involving funds administered by the board. The private or independent institution of higher education's external audit must comply with the board's rules under this subchapter for auditing those funds.

(11) The board may seek technical assistance from the state auditor in establishing the compliance monitoring function. The state auditor may periodically audit the board's compliance monitoring function as the state auditor considers appropriate.

1.14 – 1.19 (No change)