TEXAS HIGHER EDUCATION COORDINATING BOARD

INTERNAL AUDIT
ANNUAL REPORT

FOR
FISCAL YEAR 2015
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Compliance with Texas Government Code, Section 2102.015

Texas Government Code, Section 2102.015 requires state agencies to post on the agency’s Internet Web site its internal audit plan, internal audit annual report, and any weaknesses or concerns resulting from the audit plan or annual report. Please see the Coordinating Board internet web site at http://www.thecb.state.tx.us/ and the “Internal Audit and Compliance Monitoring” tab for this required information. The 2015 Internal Audit Annual Report will be posted following its presentation to the board in October, 2015.
Compliance with the Benefits Proportionality Audit Requirements for Higher Education Institutions

This requirement was not applicable to the Texas Higher Education Coordinating Board.
**FY 15 Internal Audit Plan Assessment/Status**

Explanatory Information - The table below indicates the status of FY 15 planned audits, as shown on the approved audit plan, versus those accomplished during the year.

<table>
<thead>
<tr>
<th>Board-Approved FY 15 Audit Plan</th>
<th>Status of Audit at 8/31/15</th>
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</thead>
<tbody>
<tr>
<td>Follow Up Audits</td>
<td>The follow-up audits were not yet completed at fiscal year-end, and will be completed in fiscal year 2016. (1) Follow Up Audit on an Internal Audit of Texas Research Incentive Program Administration THECB-IA-WP-15-176 will be reported October 21, 2015. (2) Follow Up Audit of A Review of BOT Loan Administration THECB-IA-WP-15-177—work in progress: expected reporting date January, 2016. (3) Follow Up Audit of A Review of BOT Loan Funding THECB-IA-WP-15-178—work in progress: expected reporting date January, 2016.</td>
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<tr>
<td>Self-Assessment of Work Quality, Internal Audit</td>
<td>This audit was not yet completed at fiscal year-end, and will be completed in fiscal year 2016. Expected reporting date January, 2016.</td>
</tr>
<tr>
<td>Review of College Access Loan at the THECB</td>
<td>This audit was not yet completed at fiscal year-end, and will be completed in fiscal year 2016. Work in progress; expected reporting date January, 2015.</td>
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</tbody>
</table>
LIST CONSULTING ENGAGEMENTS AND NON-AUDIT SERVICES COMPLETED

The Texas Higher Education Coordinating Board internal audit function did not perform consulting or non-audit services in fiscal year 2015.
External Quality Assessment of the Internal Audit Activity at

May 2013
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EXECUTIVE SUMMARY
As requested by the chief audit executive (CAE), the Institute of Internal Auditors, Inc. (IIA) conducted an external quality assessment (QA) of the internal audit activity (IA activity) of the Texas Higher Education Coordinating Board (THECB). The principal objectives of the QA were to assess IA activity’s conformance to the IIA’s International Standards for the Professional Practice of Internal Auditing (Standards), evaluate the IA activity’s effectiveness in carrying out its mission (as set forth in its charter and expressed in the expectations of the THECB management), and identify opportunities to enhance its management and work processes, as well as its value to the THECB.

OPINION AS TO CONFORMANCE TO THE STANDARDS
It is our overall opinion that the IA activity generally conforms to the Standards and Definition of Internal Audit. For a detailed list of conformance to individual Standards, please see Attachment A. The QA team identified opportunities for further improvement, details of which are provided in this report.

The IIA Quality Assessment Manual suggests a scale of three ratings, “generally conforms,” “partially conforms,” and “does not conform.” “Generally Conforms” is the top rating and means that an internal audit activity has a charter, policies, and processes that are judged to be in conformance with the Standards (or as appropriate). “Partially Conforms” means deficiencies in practice are noted that are judged to deviate from the Standards, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner. “Does Not Conform” means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

SCOPE AND METHODOLOGY
As part of the preparation for the QA, the IA activity prepared an advanced preparation document with detailed information and sent out surveys to a representative sample of the THECB executives and operating managers. A summary of the survey results (without identifying the individual survey respondents) have been furnished to the IA activity. Prior to commencement of the onsite work by the QA team on May 6, 2013, the team leader conducted a preliminary meeting with the CAE to gather additional background information, select executives and managers for interviews during the onsite field work, and finalize planning and administrative arrangements for the QA. As a part of the review, extensive interviews were held with the THECB Agency Operations Committee Chairman, executives and managers (including heads of operating and support divisions), external auditors, the Texas State Auditor and IA activity staff. Also reviewed were the IA activity’s risk assessment and audit planning processes, audit tools and methodologies, engagement and staff management processes, and a representative sample of the IA activity’s working papers and reports.
OBSERVATIONS AND POSITIVE ATTRIBUTES

The IA activity environment where the review was performed is well-structured and progressive, where the Standards are understood and management is endeavoring to provide useful audit tools and implement appropriate practices. Some successful practices observed were:

- Establishing effective business relationships, where the CAE is a respected member of the executive management team, regularly offering advice and counsel,
- Working collaboratively with management in:
  - Assessing risk and scope projects,
  - Providing input into policies under development, and
  - Responding to questions and offering feedback regarding governance, risk and control.
- Mentoring, advising and coordinating activities with the newly-established Compliance Monitoring group,
- Assisting and coordinating all external audit activity, and providing direct support to the external auditors performing the agency stand-alone financial statement audit.
- Internal Audit staff members are experienced practitioners and hold a number of professional certifications that demonstrate a commitment to excellence.

Consequently, comments and recommendations are intended to build on this foundation already in place within the IA activity.

RECOMMENDATIONS

Recommendations are divided into two groups:

- First are those that concern the THECB as a whole and suggest actions by senior management. Some of these are matters outside the scope of the QA, as set out above, which came to attention of the quality assessment team through the surveys and interviews. These are included because they will be useful to the THECB Board and management because they impact the effectiveness of the IA activity and the value it can add.
- Second are those that relate to the IA activity’s structure, staffing, deployment of resources, and similar matters that should be implemented within the IA activity, with support from senior management.

Highlights of the more significant recommendations are set forth below, with details in the main body of the report.
PART I – MATTERS FOR CONSIDERATION OF THE TEXAS HIGHER EDUCATION COORDINATING BOARD AND MANAGEMENT

1. Prepare a written Charter for the Agency Operations Committee (AOC) that formally establishes their authority and responsibility for the oversight of the IA activity. (Practice Advisories 1110-1 and 1111-1)

2. Maximize the Effectiveness and Efficiency of assurance activity in order to increase the consistency, effectiveness and efficiency of both internal and external compliance services. (Practice Advisory 2050-1)

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Strengthen the Quality Assurance and Improvement Program (QAIP) by implementing procedures to periodically self-assess IA activity conformance with the IIA Standards, Definition of Internal Auditing, and the Code of Ethics. (Standard 1311)

2. Strengthen the communication of IA activity resource requirements by working with the AOC in establishing a frequency schedule that fully aligns the IA annual plan with the ThECS risks and its strategic plans and objectives. (Standard 2020)

3. Develop a more detailed functional information technology (IT) audit universe in order to better determine the IT audit resources needed to properly meet the strategic plans and objectives the ThECS. (Standard 2020)

4. Enhance methods to promote the IA activity within the ThECS to more fully inform management and staff members about Internal Audit’s role and responsibilities. (Successful Practice)

Thank you for the opportunity to be of service to the Texas Higher Education Coordinating Board. The QA team will be pleased to respond to further questions concerning this report and to furnish any desired information.

George Shomo, CPA, CFE, CGMA
Team Leader

Debi Roth, CIA
Director, Quality
The Institute of Internal Auditors

Team Member:
David J. MacCabe, CIA, CGAP, CRMA, MPA
OBSERVATIONS AND RECOMMENDATIONS

PART I – MATTERS FOR CONSIDERATION OF THE TEXAS HIGHER EDUCATION COORDINATING BOARD AND MANAGEMENT

These observations and recommendations originated principally from the comments received from the management survey, interviews with selected executives, and follow-up of these matters. All are of direct importance to enhancing the effectiveness and added value of the IA activity.

1. Prepare a Written Charter for the Agency Operations Committee

The Agency Operations Committee (AOC), which is the equivalent of an audit committee, is comprised of members of the Board. It has been noted that the AOC does not operate under a formal written document, such as a committee charter. While the functional relationship between the AOC and the IA activity has been properly established and provides for required IA activity organizational independence, the lack of a written document has led to some confusion about the duties between the functional and administrative reporting lines. However, the internal audit charter does address the responsibilities and reporting lines of the IA activity.

Recommendations

Consider preparing a written document that establishes AOC authority for the oversight of the THECB IA activity, and clearly defines their responsibilities in providing that oversight. The AOC could seek the assistance of the CAE in drafting the document and may consider using the IIA Model Audit Committee Charter as a guide. The document should be sent to the full Board for formal approval. Executive management should be fully aware of the responsibilities of the AOC in order to ensure duties are properly separated between the functional and administrative reporting lines of the IA activity within the THECB.

Examples of functional reporting responsibilities include:

- Approving the internal audit charter;
- Approving the risk-based internal audit plan;
- Approving the internal audit budget and resource plan;
- Receiving communications from the chief audit executive on the internal audit activity’s performance relative to its plan and other matters;
- Approving decisions regarding the appointment and removal of the chief audit executive;
- Approving the remuneration of the chief audit executive; and
- Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.

Also, the AOC should meet in private session with the CAE at least annually.
Board and Senior Management Response

We concur with the auditor’s recommendation. A written charter for the AOC is under development and will be completed and submitted to the Board for approval at the October, 2013 Board meeting. The draft charter will clarify the AOC’s role and responsibility, including its role and responsibility as it pertains to the Internal Audit and Compliance Monitoring functions.

2. Maximize the Effectiveness and Efficiency of Assurance Activity

Recently, in response to an evaluation made by the Texas Sunset Advisory Commission, the THECB redirected some of its staff resources in establishing a new function to monitor expenditure compliance and data accuracy by external stakeholders among institutions of higher education. This function has been named the “Compliance Group” and has been placed within the organization of the Deputy Commissioner of Finance and Administration/Chief Operating Officer.

Interviews with executive management indicated the approach of separation of the Compliance Group and the IA activity is not ideal, but was implemented to follow the advice of the Texas Sunset Advisory Commission. Based on a description of the duties of the Compliance Group provided through these interviews, they would be conducting reviews of contracts. In effect, the Compliance Group will be providing assurance services. As required by the Standards, the CAE has established communication with the Compliance Group to allow for proper coordination. However, there may be an opportunity to enhance the efficiency and effectiveness of the IA activity.

Recommendations

Executive Management and the AOC should evaluate the placement of the Compliance Group and consider positioning under the direction of the CAE. A decision to consolidate may be based on the following factors:

- The work performed by the Compliance Group is a form of assurance service currently provided by the IA activity.
- The CAE is charged with the responsibility for assurance services conducted relative to the THECB.

Board and Senior Management Response

We concur with the recommendation. Organizational placement of the Compliance Monitoring function will be moved to report to the Director of Internal Audit (and Compliance) effective September 1, 2013. The new placement of the Compliance Monitoring function will provide management with reasonable assurance of the effectiveness and efficiency of both functions, since they will be following auditing standards that ensure consistent, reliable results. This organizational placement also provides quality assurance and improvement that is built into work processes of both groups, including Internal Audit and Compliance Monitoring receiving
independent evaluation/oversight through an external quality assurance review once every three years.

PART II – ISSUES SPECIFIC TO THE INTERNAL AUDIT ACTIVITY

1. Strengthen the Quality Assurance and Improvement Program

The CAE has implemented a formal Quality Assurance and Improvement Program (QAIP). However, the QAIP does not include provision for performing periodic self-assessments to evaluate conformance with the Definition of Internal Auditing, The Code of Ethics, and the Standards. Also, the IA activity has not fully implemented a system of performance measurement to assist in efforts to enhance the quality of services provided.

Recommendation

Include within the QAIP, the periodic assessment of the IA activity in conformance to the IIA definition of Internal Auditing, Standards, and Code of Ethics. Also, expand the use of performance metrics as an aide in developing plans to continually improve IA activity performance.

Internal Audit Response

Internal Audit fully supports a rigorous program of Quality Assurance and Improvement. Department procedures establish a three year interval for external quality assurance assessment, consistent with the requirements of the Texas Internal Auditing Act. These procedures further specify that during the first two years of this three year cycle, Internal Audit will perform a comprehensive self-assessment of its conformance to the IIA definition of Internal Auditing, the Standards, and the Code of Ethics. The results of both external quality assurance assessments and internal quality assurance assessments will be reported to the Agency Operations Committee.

The Chief Audit Executive developed the first set of internal audit performance metrics during fiscal year 2013, as defined in department procedures. The presentation of actual results in comparison to targets will be done at the conclusion of each fiscal year, at the October Agency Operations Committee meeting. The current set of four performance metrics will be expanded for fiscal year 2014, and the new metrics will be presented at the October 2013 Agency Operations Committee meeting.

2. Strengthen the Communication of IA Activity Resource Requirements

While the CAE properly communicates the annual plan to executive management and the AOC for approval and provides assurances as to the adequacy of resources to complete the plan that is communicated, the approach to determining the engagements to be included in the plan does not adequately allow for an evaluation of the resources required to properly support the THECB in meeting its goals, objectives and strategic initiatives, nor does it provide for the identification
of possible resource limitations. Based on what is not in the presented audit plan and the inadequacy of the plan to encompass more activities to meet the objectives of the organization, the AOC does not receive sufficient information to make the most appropriate determination on approval of the plan. Further, the CAE has not engaged the AOC in establishing a frequency schedule that reflects the risk appetite of the organization.

**Recommendation**

To ensure the AOC receives appropriate information to make determinations on the audit plan, revise the basis for selecting engagements for inclusion in the IA activity annual plan. Elements to consider include:

- Work with the AOC in developing a “Frequency Schedule” relative to the annual audit risk assessment and reflective of the organizational risk appetite.
- Use the Frequency Schedule to establish the engagements required to be included in the current year plan, with all remaining auditable entities scheduled in a long term plan.
- Engage the AOC and executive management in a discussion of resource shortages projected either in the current year or long term plans. Any decision made to not meet resource requirements must reside with the AOC; and they will need to identify those engagements to be deferred. The impact of any deferrals should be projected into the long term plan.

**Internal Audit Response**

Internal Audit presented information to enhance AOC and management decision making processes at the July AOC meeting. The presentation addressed auditable units and an evaluation of the resources required to support the Agency in meeting its goals, objectives and strategic initiatives, as well as the identification of possible resource limitations. The Annual Internal Audit Plan showed each of the main organizational areas, and the audit emphasis for the current plan as well as a cycle/frequency approach to achieve coverage of all organizational areas over a specified number of years. The approach allowed for an informed discussion regarding the level of audit resources, the risk appetite, and the impact of resource changes on the frequency schedule.

3. **Develop a More Detailed Functional Information Technology Audit Universe**

The IT audit universe defined in the annual risk assessment model contains six high-level categories or auditable activities. Each category is generally broad, and contains multiple functions that could require audit coverage and should logically be risk assessed at a more detailed level. Based on broadness of the universe the plan communicated does provide for the most appropriate determination on the adequacy of coverage.
Recommendation

Define the audit universe related to the THECB IT resource (ISS) in a more functional and detailed format in order to better determine the IT audit resources needed to properly meet the objectives and strategic plans of the THECB. The CAE could consider utilizing the services of a consultant specialist to assist in building a more robust universe. Further, developing a more robust universe will most likely lead to a need for more IT audits, where more technical IT audit expertise will be required. The CAE could begin long term planning to meet the anticipated demand for these resources.

Internal Audit Response

Internal Audit has already initiated conversations with the Chief Information Officer and gathered information from other organizations regarding the enhanced definition of the information technology audit universe. This approach was used in the short term to arrive at risk-based information technology audits for the FY 2014 Internal Audit Plan. A budget request was approved to obtain the assistance of a consultant during FY 14, to make further suggestions regarding information technology risk assessment and to better estimate future resource requirements.

4. Enhance methods to promote IA within the THECB

During the external assessment several members of management indicated there is an opportunity to promote the IA activity by providing for a more complete understanding of the role, responsibilities, and services of the IA activity.

Recommendation

Consider further opportunities to more fully inform THECB management and staff members about Internal Audit’s role and responsibilities. Efforts to broaden communication and understanding of Internal Audit’s role and responsibilities can lead to a stronger control environment and improved coordination with business partners.

Marketing the internal audit function can further enhance and nurture effective working relationships with business partners. Such efforts may include presentations, training topics, sandwich seminars, and individual and group discussions. Adding a web page on the agency’s Intranet (CB Net) would be another way of explaining the IA role, the audit process, the work of external audit groups, and some basic risk and control concepts.

Internal Audit Response

Internal Audit will bolster efforts to further promote its role, responsibilities, and services. A previously tabled effort to develop an Internal Audit website will be re-evaluated, and a progress report will be made at the October AOC meeting.
## The Texas Higher Education Coordinating Board

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<thead>
<tr>
<th>Overall Evaluation</th>
<th>GC</th>
<th>PC</th>
<th>DNC</th>
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## Performance Standards

<p>| 2000 Managing the Internal Audit Activity | x | | |
| 2010 Planning | | | |
| 2020 Communication and Approval | x | | |
| 2030 Resource Management | x | | |
| 2040 Policies and Procedures | x | | |</p>
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<td>Criteria for Communicating</td>
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<td>Quality of Communications</td>
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<td>Errors and Omissions</td>
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<td>2431</td>
<td>Engagement Disclosure of Nonconformance</td>
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<td>2800</td>
<td>Management’s Acceptance of Risks</td>
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<td>IIA</td>
<td>Code of Ethics</td>
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TEXAS HIGHER EDUCATION COordinating Board

INTERNAL AUDIT

Audit Plan

Fiscal Year 2016

The Texas Internal Auditing Act requires state agency Internal Auditors to conduct a program of auditing that includes an annual audit plan, is prepared using risk assessment techniques, and identifies the individual audits to be conducted during the year. The following proposed plan meets the requirements of the Texas Internal Auditing Act.

Specific risk factors were considered as they apply to the agency’s significant operational activities. These risk factors included:

- Financial significance
- Reputational significance and visibility
- Complexity; inherent risk; and the potential for abuse
- Prior audit and compliance monitoring results as an indicator of control effectiveness
- Audit recency – internal audit, compliance monitoring (as applicable), KPMG, SAO, and/or Federal auditors
- Changes in mission or key management

A risk-ranked listing of significant operational activities became the basis for the audits proposed for consideration herein.

A. Required Audits

<table>
<thead>
<tr>
<th>Audit Activity</th>
<th>Estimated Hours Required</th>
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<tbody>
<tr>
<td>2. Follow Up of Prior Internal Audits</td>
<td>180</td>
</tr>
<tr>
<td>Assess the implementation status of previously reported internal audit findings in the areas of TEXAS Grant Administration, Contract Management, and CAL Administration.</td>
<td></td>
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<tr>
<td>3. Follow up of Prior State Auditor’s Office Audit</td>
<td>390</td>
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<tr>
<td>Assess the implementation status of previously reported SAO findings.</td>
<td></td>
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<tr>
<td>4. Self-Assessment of Work Quality, Internal Audit</td>
<td>150</td>
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<tr>
<td>Perform a self-assessment of internal audit work quality, in accordance with the requirements of professional auditing standards.</td>
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<tr>
<td>5. Investigations</td>
<td>350</td>
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</tbody>
</table>
Texas Government Code Chapter 321.022, Coordination of Investigations, requires the coordination of investigations between the agency and the Texas State Auditor’s Office. If the administrative head of an agency that is subject to audit by the state auditor has reasonable cause to believe that money received from the state by the agency or by a client/department of the agency may have been lost, misappropriated, or misused, or that other fraudulent or unlawful conduct has occurred in relation to the operation of the agency, the administrative head shall report the reason and basis for the belief to the state auditor. The state auditor may investigate the report or may monitor any investigation conducted by the agency.

6. Provide Assistance--External Audit of Agency Financial Statements

Internal Audit provides 50 hours of audit support to reduce external audit fees and to increase the level of knowledge of external auditors’ assessment of the agency’s financial statements and associated risks.

B. Risk-Based Audits

7. Review of Tuition Equalization Grant (TEG) Administration
   Review internal administrative activities associated with the TEG Program. TEG disbursements for fiscal year 2014 were approximately $89 million.
   410

8. Review of Physical Security of Information Systems
   Review physical security controls of agency information systems.
   470

9. Review of Contract Management Administration
   Review agency contract administration processes for compliance with laws, regulations, policies, and procedures.
   443
EXTERNAL AUDIT SERVICES PROCURED IN FY 2015

The agency contracted with KPMG, LLP, to perform an independent audit of the agency’s Fiscal Year 2014 Financial Statements. As part of the agreement, the agency provided 50 hours of internal audit staff support to KPMG, LLP.

REPORTING SUSPECTED FRAUD AND ABUSE

Actions taken by the agency to address the requirements of Section 7.10.Fraud Reporting, General Appropriations Act (82nd Legislature), Article IX and Government Code, Section 321.022.Coordination of Investigations, include:

1) Established a fraud prevention policy and posted the policy on the agency intranet for the employees. The policy encourages reporting of suspected violations to the State Auditor’s Office Fraud Hotline.

2) Established a link to the State Auditor’s Office Fraud Hotline on the agency’s home page to enable the general public or employees to report suspected fraud or misconduct directly to the State Auditor’s Office.

3) Coordinated with the Special Investigations Unit of the State Auditor’s Office to investigate suspected fraud.

4) Provided ethics-related information to all new employees as part of the orientation process.

5) Provided risk and controls training to agency management, including discussion of fraud and ethics policies and responsibilities.