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December 20, 2017

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Dr. Raymund A. Paredes
Commissioner of Higher Education
1200 E. Anderson Lane
Austin, TX 78752

Dear Dr. Paredes:

I am attaching the final report of *An Internal Audit of Contract Administration at the Texas Higher Education Coordinating Board*, Report No. THECB-IA-WP-17-195. The report will be presented at the January 2018 Agency Operations Committee meeting.

The issues presented in this report resulted in a Category 3 Report Rating. This report contains observations that, either individually or collectively, pose a significant risk for negative reputational or financial consequences. Executive management and board attention is specifically directed to this report.

If you have any questions or comments, please let me know.

Sincerely,

A handwritten signature in black ink that reads "Mark A. Poehl".

Mark A. Poehl, CPA, CIA, CISA, CFE
Director, Internal Audit and Compliance

EXECUTIVE SUMMARY

The contract administration process includes the life cycle of a grant and/or contract from start to finish and spans across multiple departments within the agency. For this audit, the grants and contracts reviewed cover the period between 2008 and 2013.

The contract administration audit processes over contract administration are generally effective in ensuring that contracts are administered in accordance with the Coordinating Board (CB) rules and related statutes. However, significant improvement is needed to reduce risk and strengthen controls, including:

- *Financial monitoring of state grant expenditures require further improvement;*
- *Conflict of interest policies related to creating an appearance of impropriety, require further improvement regarding employee situations with close friend and business relationships; and*
- *Procedures to notify institutions of potential conflicts of interest caused by THECB contracts with the institution's employees require further improvement.*

Please see detailed Observations, Recommendations, and Management Responses for additional information.

Audit Objective and Scope

Our audit objective was to review internal activities associated with contract administration and to evaluate the sufficiency of internal control. We adjusted the scope of our audit to focus specifically on developmental education-related grants, from 2008 to 2013, that related to a former Texas State University faculty member indicted for felony theft. Specifically, the faculty member had grants with the Coordinating Board through Texas State University as well as separately as a consultant.

Our contract administration audit focused on the controls and governance of these contracts. Our scope focused on administrative processes and included tests of specific contracts with Texas State University and the faculty member, as noted in Appendix A, and review of agency staff interactions with the faculty member. The review disclosed weaknesses in contract administration oversight, therefore, the remainder of the review concentrated on agency policies and procedures.

Our audit included reviewing relevant statutes, rules and CB policies and procedures, manuals and documentation related to contract administration processes. We interviewed appropriate CB staff, collected data and performed various testing to address the audit objectives.

We conducted this audit in conformance with the *International Standards for the Professional Practice of Internal Auditing*. Additionally, we conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our

findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The phases of contracting involve multiple parties from across the agency. The diagram below shows contract related tasks and primary responsibility areas with the understanding that there is some overlap of responsibility between all the organizational areas.

Contract Responsibilities by Organizational Area

Task/Responsibility	Executive Management	Office of General Counsel	All Agency Divisions	Finance Division
Policy development	X			
Training requirements	X			
Determine acceptable level of risk	X		X	
Contract formation		X		
Contract compliance through execution		X		
Legal compliance through execution		X		
Contract initiation/ Initial Contract formation			X	
Risk assessment			X	
Contract and financial monitoring and compliance post execution			X	
Invoice payment				X
Invoice documentation compliance				X

Electronically, the contract administration process is centralized and automated with the use of the Business Management System (BMS) which is an enterprise database system customized and administered by THECB. The agency's contract administration function is spread among all areas of the agency as noted in the diagram above. Internal Audit previously reviewed the oversight phase of the Contract Management Cycle in its report issued April 23, 2015, and the formation phase in its report issued September 14, 2016.

Detailed Observations, Recommendations, and Management Responses

1. *Financial monitoring of state grant expenditures require further improvement.*

Financial monitoring of state grant expenditures require further improvement. State grant standards provide the required guidelines and responsibilities for grant management for state agencies. Current practices do not provide an adequate level of review of financial documents and do not ensure that state awards are used for authorized purposes.

The Uniform Grant Management Standards (UGMS) are authorized according to Chapter 783 of the Texas Government Code, are provided by the Texas Comptroller of Public Accounts, and provide guidelines and standards for state grant management by state agencies.

The UGMS provides state agencies that award grants monitoring responsibilities that are similar to federal grant guidelines. As noted in the UGMS, (page 119), "The state awarding agency shall ... [m]onitor the activities of recipients as necessary to ensure that state awards are used for authorized purposes in compliance with laws, regulations, and the provision of contracts or grant agreements and that performance goals are achieved."

UGMS page 119: *"The state awarding agency shall ... [m]onitor the activities of recipients as necessary to ensure that state awards are used for authorized purposes in compliance with laws, regulations, and the provision of contracts or grant agreements ..."*

In addition to general monitoring requirements, the UGMS provides guidelines on the level of detail needed to substantiate costs. This level of detail is stated in UGMS, under Basic Guidelines, (page 13), "To be allowable under federal or state awards, costs must ... [b]e adequately documented. Documentation required may include, but is not limited to, travel records, time sheets, invoices, contracts, mileage records, billing records, telephone bills and other documentation that verifies the expenditure amount and appropriateness to the grant."

In compliance with UGMS, at least some other agencies apply the same level of review for both federal and state grants. For example, the Texas Education Agency (TEA) uses the same general and fiscal guidelines for all grants administered by the TEA. As part of their guidelines, TEA employs various criteria to ensure that funds are spent in accordance with grant guidelines. In some cases, they require manual approval, including additional supporting documentation, such as general ledgers, payroll ledgers, payroll checks, invoices, receipts and travel vouchers. Manual approval is typically required when payment requests exceed predetermined thresholds or other criteria.

With respect to current practices at THECB, none of the contracts reviewed included any request for documentation to substantiate grant expenditures other than the invoice submitted by the institution. The invoices by themselves, listing only broad categories of expenditures, do not include sufficient documentation to determine that the expenditures were appropriate to the grant.

Furthermore, the State of Texas Contract Management Guide, (page 111), supports the need for requiring more than an invoice for monitoring purposes, stating, "Costs incurred or invoices submitted, in and of themselves, are insufficient indicators of the contractor's progress."

An absence of minimum standards to provide sufficient financial monitoring of state grant expenditures created the opportunity for grant funds to be expended for inappropriate purposes, including potentially felony theft by a former Texas State University faculty member. Sufficient monitoring must do more than solely rely on invoices from the institution as an indicator that grant expenditures are appropriate.

In addition, since Texas State University identified some expenditures as inappropriate, further review of grant expenditures by the CB and Texas State University will be needed to identify the recoupment amount that Texas State University should provide to the Coordinating Board for the inappropriate use of grant funds.

Recommendations

Revise policies and procedures to provide sufficient financial monitoring of state grant awards to reasonably ensure that funds are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements.

Engage in discussions with Texas State University in determining the recoupment amount that Texas State University should provide to the Coordinating Board for the inappropriate use of grant funds.

Management response

Management agrees with the recommendations.

Grants staff in the College Readiness and Success, Academic Quality and Workforce, and Strategic Planning and Funding divisions will meet monthly with the Director of Contracts and the Director of Procurement to review issues and potential concerns. They will share lessons learned and best practices in grants management. They will be tasked with sharing and communicating existing state and OMB grant management standards with new managers. The committee will develop common standards including sufficient financial monitoring to be employed across the divisions and will recommend modifications or additions when needed.

The discussions with Texas State regarding the recoupment will be conducted by a subject matter expert from the grant area in consultation with THECB Audit.

Implementation Date

The Committee began meeting in October 2017 and will be given a formal charge January 2018. Common standards will be completed by June 2018.

Recommendations for recoupment will be recommended to agency management as soon as events external to the THECB's purvey have been addressed.

Responsible Party(ies)

David Gardner, Deputy Commissioner for Academic Planning and Policy.

Jerel Booker, Assistant Commissioner for College Readiness and Success will be responsible for the analysis of recoupment.

2. Conflict of Interest policies related to creating an appearance of impropriety, require further improvement regarding employee situations with close friend and business relationships.

Conflict of interest policies related to creating an appearance of impropriety, require further improvement regarding employee situations with close friend and business relationships. As reflected in current law, existing CB conflict of interest policies allow employees to exchange favors with friends and business relationships as long as the favor is not given as part of their official status or the favor is not given in exchange for a work-related decision. However, exchanges of favors, when the relationships overlap with responsibilities to administer contracts and grants, may create an appearance of impropriety because they could be construed as inappropriately accepting a benefit in return for a work-related decision.

Both the Texas Ethics Commission, in their "Guide to Ethics Laws for State Officers and Employees" and the THECB General Counsel Ethics page, note that employees should act fairly and honestly and should avoid creating even the appearance of impropriety.

However, exchanging favors between close personal and business relationships can create the appearance of impropriety when those relationships overlap with responsibilities to administer contracts and grants.

A Guide to Ethics Laws for State Officers and Employees, page 1: *"As a public servant you should act fairly and honestly and should avoid creating even the appearance of impropriety."*

These examples of the appearance of impropriety, taken in their totality over a period of years, could be construed to be exchanging favors or sharing confidential information:

- a) Registering for training for a business of a vendor/grantee and stating "I've got to show my support for [outside private business of the vendor],"
- b) Receiving correspondence from a vendor/grantee with the phrase "Attachment is for your eyes only,"
- c) Requests from a vendor/grantee for support letters for other proposals,
- d) Sending correspondence with a vendor/grantee stating "I don't know if I am allowed to share this, but ...,"
- e) Sending correspondence with a vendor/grantee stating "Thanks. I owe you one" followed by "Nope... I'm simply reducing my debt,"
- f) Using state funds to attend a conference primarily as a reason to get together with others, potentially abusing use of funds,
- g) Discussion with a vendor/grantee of willingness of THECB leadership to provide more funds and the discussed maximums,
- h) Discussion with a vendor/grantee of how to get leadership to let go of more money,
- i) Providing references for a vendor/grantee, and vice versa, for other employment,
- j) At the request of vendor/grantee, due to a specific internal request for a final report from their Office of Special Programs, relaxing the requirements of a final report to allow an oral final report when a written report is customary, and drafting a document for the vendor/grantee, explaining how the report requirements were fulfilled, and
- k) Using inappropriate terms of endearment in business communications, such as "Good morning pretty lady," "Hey Ladybug," "My pretty," and "Hey Chickie."
- l) Receiving dissertation preparation and advice from a Project Director of a grant, while simultaneously monitoring compliance for the grant.

All of the above examples of exchanging favors, demonstrate poor judgement and give an appearance of impropriety, because they could be construed as inappropriately accepting a benefit in return for a work-related decision.

THECB has policies that require employees and board members to identify relatives that may be considering a contractual relationship with THECB. THECB also has policies specifically related to purchasing personnel. However, there are no THECB policies for other employees to identify potential conflicts of interest involving friendships or close business relationships that may be the basis for bias in carrying out their official duties.

THECB Ethics policy
Chapter E – 01 (4) (E): *"An employee shall identify to the General Counsel any relative of the employee that may be considering a contractual relationship with the Board."*

The lack of policies and guidance to employees with regard to handling close business relationships and friendships that are related to official THECB business increases the agency's risk of maintaining the highest standards of stakeholder trust.

Recommendations

Update policies and provide additional training and education to employees regarding conflict of interest policies for employees regarding situations with close friend and business relationships.

Management response

Management agrees with the recommendation.

A training program is being developed using the THECB Ethics training as a base. Examples will be added specifically related to grants management including conflicts of interest, appearance of impropriety, and communicating with grantees.

Implementation Date

No later than April 2018. Completion no later than May 2018 and the training will be provided to those staff taking on management responsibilities going forward and any others who have responsibilities related to grants and contracts.

Responsible Party(ies)

Development of the training will be coordinated by David Gardner, Deputy Commissioner for Academic Planning and Policy, in consultation with Linda Battles, Deputy for Agency Operations and Communications, and William Franz, General Counsel.

3. Procedures to notify institutions of potential conflicts of interest caused by THECB contracts with the institution's employees require further improvement.

Procedures to notify institutions of potential conflicts of interest caused by THECB contracts with the institution's employees require further improvement. THECB occasionally contracts with employees of other state agencies, primarily institutions of higher education, to provide goods and services, such as consulting services. Although it is the employee's responsibility to notify their employer of outside employment, THECB, as the contracting state agency, is fully aware of the outside employment and should notify other state employers of the potential conflict of interest for their review.

Review of contracts with Texas State University identified that Texas State University was not aware of at least one consulting contract between a former Texas State University faculty member and the THECB. The faculty member reportedly failed to disclose the contract to Texas State University, potentially causing an undisclosed conflict of interest.

Prior to this engagement, THECB did not have policies and procedures for notifying other state employers prior to executing a contract with a consultant. Failure to notify other state employers, particularly in light of conflict of interest policies for state employees, could allow THECB to unknowingly facilitate non-compliance with state and institutional conflict of interest policies. During the engagement, the agency began notifying other state employers prior to executing a contract with a consultant.

Recommendations

Continue with revised practice to notify the other state employers for consultants to reduce the risk of non-compliance of conflict of interest policies.

Management response

Management agrees with the recommendation.

Implementation Date

This has been implemented.

Responsible Party(ies)

This has been implemented.

PERFORMED BY:

Mr. Paul Maeyaert, JD, MBA, CIA, CGAP; Auditor

cc:

THECB

Board Members

Commissioner's Office

Dr. David Gardner, Deputy Commissioner for Academic Planning and Policy

Ms. Linda Battles, Deputy Commissioner for Agency Operations and Communications

Mr. William Franz, General Counsel

Mr. Ken Martin, Assistant Commissioner for Financial Services and Chief Financial Officer

College Readiness and Success

Mr. Jerel Booker, Assistant Commissioner

Dr. Kristen Kramer, Deputy Assistant Commissioner

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Appendix A

Reviewed Grants and Contracts

	Title	Date start	Date end	Amount
1A	Math Science Technology Teacher Prep Academy (MSTTPA) Phase 2	11/24/2008	12/31/2013	\$ 549,736
1B	Math Science Technology Teacher Prep Academy (MSTTPA) Phase 3	7/1/2009	8/31/2013	\$ 314,528
2	Focus Fundamentals of Conceptual Understanding & Success – Developmental Ed. Dev. Program (DEDP)	6/1/2010	8/31/2013	\$ 530,000
3	Evaluation Comprehensive Student Success Program (CSSP) (State Funds)	7/15/2011	1/31/2013	\$ 302,304
4	Center for Mathematics Readiness	8/15/2011	8/31/2012	\$ 125,000
5	Complete College America Project (CCA-Focus)	9/26/2011	10/31/2013	\$ 255,000
6	Evaluation CSSP (Fed Funds -84.378a ACG)	10/31/2012	12/10/2013	\$ 230,000
7	Adult Basic Ed Innovation Grant	8/10/2011	10/31/2013	\$ 299,895
8	Bridging programs -Review 2009 & 2010 Math curriculum - 2010 Fall debriefing meeting	5/1/2010	11/30/2010	\$ 5,000
9	Intensive Program – Adult Education Students (IP-AES) - Review 2009 & 2010 Math curriculum plans - winter 2011 DEDP meeting	12/15/2010	8/1/2011	\$ 6,000
10	DEDP-Review math curriculum - conduct workshop	4/8/2011	7/1/2011	\$ 3,000
11	Bridging programs -Review 2010 & 2011 Math curriculum - Fall debriefing webinar	3/1/2011	11/30/2011	\$ 5,000
12	IP-AES -Review 2010 & 2011 Math curriculum plans - winter 2012 grantee meeting	2/21/2012	8/31/2012	\$ 6,000
13	Co-facilitate faculty teams -developmental mathematics -S3 grantees	12/10/2012	8/31/2013	\$ 14,000
	Total Grants and Contracts Reviewed			\$ 2,645,463¹

¹The Audits and Analysis department of Texas State University determined a total of approximately \$80,814 in potential questionable expenditures with an amount submitted for the indictment of approximately \$21,508 of potential misappropriated funds.