



Program Audit Study Committee Report on  
Streamlining Accountability Procedures and Reducing  
Reliance on Contact Hours

Reported to the  
Joint Legislative Education Oversight Committee

December 1, 2014

## Executive Summary

During the 2013 Legislative Session, the General Assembly eliminated recurring funds for the Audit Services Section of the System Office, a team of seven full-time employees that conducts annual program audits as required by G.S. 115D-5(m). For the 2013-15 fiscal biennium, funding for this team was appropriated on a non-recurring basis pending the results of a study conducted by a legislatively established committee, herein referred to as the Program Audit Study Committee.

As a result of over a year of study and deliberation, the Program Audit Study Committee concludes that an accountability function should be maintained under the State Board to ensure the credibility of the System's formula budget requests to the General Assembly and the fair allocation of State resources among the 58 institutions. An accountability function under the State Board is best positioned to 1) provide consistent assessments of the accuracy of the data used to allocate State funds and compliance with policies regarding charging and waiving tuition and fees, and 2) ensure colleges receive consistent guidance and support on compliance. **However, this accountability function should operate significantly differently from the current program audit function.**

Appendix A provides a chart summarizing the key reforms recommended by the Committee. These recommendations require action from the General Assembly, State Board, and the System Office. The Committee recommends that G.S. 115D-5(m) be amended and funding restored to enable an accountability function that is focused specifically on verifying the accuracy of colleges' full-time equivalent (FTE) student enrollment data – the primary determinant of colleges' State budget allocations – and ensuring that colleges are charging and waiving tuition and registration fees consistent with law.

The new accountability function would complement periodic reviews of college compliance with opportunities for System Office compliance and programmatic staff to coach colleges on areas of identified risk. To reduce the burden on colleges, these compliance reviews will be conducted on site and use technology to automate the process where applicable, as IT functionality is developed in the future. While there should continue to be zero tolerance for reporting fraudulent FTE data, this revised approach emphasizes working collaboratively with colleges to minimize reporting issues caused by human error and focuses findings and any associated payback of funds on systemic, material issues. **The goal is to develop an accountability system where colleges and System Office staff work in partnership to productively identify ways to improve compliance.**

In addition to making recommendations on how program audit procedures may be streamlined to minimize the administrative burden on the colleges, the 2013 legislation also charged the Program Audit Study Committee with considering how funding mechanisms may be changed to reduce reliance on contact hours. The Committee has concluded that continuing to calculate FTE based on the literal number of instructional minutes is unnecessarily complex and inherently contrary to two key educational trends: online instruction and competency-based education. Instead, the Committee recommends that FTE rules be revised to calculate FTE based on a standard number of instructional units prescribed by the State Board for each course in the Combined Course Library, our System's centralized and standardized list of approved courses. The Committee feels confident that the risk of compliance issues and the cost of compliance would be reduced if rules for reporting FTE were revised to be current, clear, and simplified.

**Background**

Per G.S. 115D-5(m), “The State Board of Community Colleges shall maintain an education program auditing function that conducts an annual audit of each community college operating under the provisions of this Chapter. The purpose of the annual audit shall be to ensure that college programs and related fiscal operations comply with State law, State regulations, State Board policies, and System Office guidance.” While the stated purpose in this statute is broad, historically program auditing has focused on ensuring colleges comply with rules regarding the reporting of student hours, which are used to determine colleges’ full-time equivalent (FTE) student enrollment. **FTE enrollment is the primary determinant of colleges’ State budget allocations.**

During the 2013 Legislative Session, the General Assembly directed the establishment of the Program Audit Study Committee, a committee of nine voting members – three State Board of Community Colleges members, three community college presidents, and three college board of trustee members – and three non-voting members – the State Auditor or designee, the State Chief Information Officer or designee, and the Community Colleges System Office Chief Financial Officer (see Appendix B for 2013 legislation).<sup>1</sup> The table below lists the individuals appointed to serve on the Committee.

<b>Program Audit Study Committee Members</b>			
<b>State Board Members</b>	<b>College Board of Trustees Members</b>	<b>College Presidents</b>	<b>Non-Voting Ex Officio Members</b>
Ann Whitford (Chair)	Lyn Austin, Johnston CC	Dr. Gary Green, Forsyth Tech	Honorable Beth Wood, State Auditor
Jimmie Ford	George Little, Sandhills CC	Dr. Steve Thornburg, Cleveland CC	Jeff King/Kristen Culler Office of State CIO
Scott Shook	Kaye Myers, Asheville Buncombe Tech	Dr. Stelfanie Williams, Vance-Granville CC	Jennifer Haygood, NCCCS CFO

Through Section 10.15(c) of S.L. 2013-360, the General Assembly directed the Committee to study the program audit function and report the results of its study and recommendations to the Joint Legislative Education Oversight Committee by January 1, 2015. The legislation specifically directed the committee to determine:

1. How program audit procedures may be streamlined to minimize the administrative burden on the institutions being audited; and
2. How funding mechanisms may be changed to reduce reliance on contact hours.

It also mandated that the Committee seek input from community college staff members who are responsible for assistance with the program audits to study the problems associated with the program audit function and potential resolutions for those issues.

Through the 2013 Appropriations Act, the General Assembly also eliminated recurring funding (\$551,572) for the Audit Services Section of the System Office, a team of seven full-time employees. For the 2013-15 fiscal biennium, funding for this team was appropriated on a non-recurring basis. As stated in the Joint Conference Report, “restoration of recurring funding is subject to the results of a study by

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<sup>1</sup> The committee membership outlined in Section 10.15(c) of S.L. 2013-360 was subsequently amended by Section 3.14 of S.L. 2013-363.

the State Board of Community Colleges in accordance with Section 10.15 of this act.” Likewise, Section 10.15(a) of S.L. 2013-360 repeals G.S. 115D-5(m), the statute that requires annual program audits, effective July 1, 2015. Consequently, the statutory mandate and funding to support program audits will no longer exist effective FY 2015-16 absent further action by the General Assembly.

### **Study Committee Activities and Findings**

The Program Audit Study Committee convened its first meeting in October 2013 and generally met on a monthly basis thereafter. To benefit from members’ expertise, the Committee invited the Program Audit Task Force to participate in its meetings. The Task Force had been meeting biannually for multiple years to discuss issues and concerns with program audits and includes community college presidents, instructional administrators, continuing education administrators, registrars, and System Office personnel (see Appendix C for membership list).

At its January 2014 meeting, the Committee directed the System Office to convene six regional Accountability Listening Sessions. The focus of these sessions was two-fold: 1) gathering feedback from colleges on policies that are unclear, obsolete, or otherwise problematic, and 2) collecting ideas about how a new and improved accountability system could work. Each college was invited to send up to three community college employees to participate in the session near their institution. The intent was to ensure that different perspectives from each college were represented, while ensuring that the sessions were not too large to discourage open conversation. The agenda found in Appendix D was provided to all participants in advance, but sessions were flexible enough to focus on whatever topics were of importance to participants.

<b>Accountability Listening Sessions</b>
• System Office: February 28, 2014
• Asheville-Buncombe Tech: March 5, 2014
• Mitchell CC: March 6, 2014
• Pitt CC: March 12, 2014
• James Sprunt CC: March 25, 2014
• Central Carolina CC: March 27, 2014

A number of themes emerged through the course of the Accountability Listening Sessions:

- **The State Board of Community Colleges Code (SBCCC) needs to be revised to ensure policies are current, clear, and simplified, where possible.** Many issues that colleges identify as audit issues are fundamentally rooted in the fact that the SBCCC has not evolved over time to keep up with changes in instructional delivery methods and other changes in practice. The existing rules for how FTEs are counted are based on a system developed when instruction was largely delivered in a traditional classroom setting where all students attended class on the same days at the same time. As a result, FTEs are counted based on the literal number of minutes of instruction provided.

Today’s instructional environment is much more varied. Classes may be provided in a traditional classroom setting, in labs, online, at clinical and other work-based learning sites, or through a combination of one or more of these settings. **Counting literal minutes in this variety of settings is extremely administratively burdensome and less applicable in online/virtual settings.** To meet student and community needs, colleges are also having to adapt to more flexible scheduling. Courses are no longer delivered solely as 16-week classes. In addition to traditional semester-long classes, colleges now offer four-week, eight-week, and 12-week classes. In certain circumstances, students may enter and exit classes at different times depending on their schedules and educational goals. This added flexibility further adds to the

complexity and burdensome nature of counting minutes of instruction. The trend towards competency-based education is fundamentally changing the landscape for instructional delivery. Under this model, the amount of time it takes to complete course content will vary for each student.

In the past, State Board rules had not evolved largely due to the cumbersome and time-consuming rule-making process. In recent years, the State Board was granted legislative authority to streamline the process for adopting State Board policies. This new streamlined process still provides for public comment, but enables the State Board to act in a much more timely manner.

- **The purpose and scope of program auditing needs to be clarified.** While the historic focus of program auditing was ensuring colleges comply with FTE rules, the purpose and scope of program audits has changed over time. Typically items would be added to the scope of the program audit in response to issues encountered with colleges. For example, a review of college intercollegiate athletic programs was added to the audit review after a high profile issue with a college's sports program arose. While the scope of program audits has been narrowed in recent years to focus more on FTE, colleges expressed significant concern about scope creep and who had the authority to change the scope of program audits. Colleges also expressed concern about being audited against standards and interpretations that are not in the SBCCC. The System Office has historically issued certain directives through "numbered memos." As personnel turn over and circumstances change, institutional knowledge of these memoranda has been lost and how they are interpreted has become inconsistent.
- **Program audits should be conducted less frequently than annually.** Currently, the statute requires that programs audits be conducted annually for all 58 colleges. By comparison, colleges are only required to have financial statement audits once every two years. Colleges questioned the amount of time and resource dedicated to annual program audits. The mandate to complete 58 audits each year with the existing staff of five auditors means that Audit Services cannot always provide "customer friendly" scheduling. It also leaves little time for Audit Services staff to conduct and receive professional development.
- **Greater consistency is needed.** Colleges expressed frustration over lack of consistency. Some colleges complained that different auditors had different record-keeping and documentation expectations. Others' concerns were focused on a lack of consistent policy interpretations – both among auditors and program staff – which is directly related to the fact that the SBCCC needs to be updated. As a result, both System Office and college employees are left to figure out how to apply existing policies to situations not anticipated by those policies. Inevitably, there are differing opinions and, therefore, inconsistency.
- **Program audits focus too much on immaterial errors.** Colleges also expressed frustration that audits "nit-picked" colleges over minor technicalities and clerical errors. Currently, colleges must revert funds (i.e. budgets are reduced) if the sum of the classes for which there are findings equate to one FTE or more, regardless of the size of the institution. Colleges felt that audits should be focused more on material violations and identifying systemic issues.
- **Class visits should be reconsidered.** Current audit procedures include visits to a sample of classes with particular emphasis on classes based on audit results from the prior year, remote/unusual locations, and unusual course titles. Some colleges felt that class visits conducted by program auditors did not provide much value and were disruptive to instruction.

- **To improve the efficiency and effectiveness of audits, auditors should perform audits on site.** The current audit process is paper intensive and requires the boxing of paper records for auditor review off site. This method of reviewing documents requires college personnel to either spend valuable work time making copies of records or accepting the risk of loss or damage inherent with removing paper records from the college campus.
- **Increase use of technology/electronic documentation to conduct audits.** Colleges strongly felt that we needed to move towards a more electronic-based, rather than paper-based system of documentation review. As colleges increasingly move toward electronic attendance and record keeping, they particularly want to leverage that technology to reduce the burden of manually providing the records required for audit review.
- **Roles and responsibilities regarding accountability need to be clarified.** Historically, auditors have been viewed by colleges as the default authority on policy guidance and interpretation, rather than programmatic staff. This fact has blurred the line between those who have the authority to develop and interpret policy and those who enforce compliance with policy. This lack of clarity regarding roles and responsibilities has exacerbated the issue of consistent policy guidance and enforcement.
- **Colleges want more guidance, training, and coaching opportunities.** Colleges consistently expressed a desire to follow the rules, but did not feel like it was easy to know about and understand those rules. In addition to current, clear, and simplified policies, colleges want a detailed audit procedures manual that clearly outlines documentation expectations. They also want more opportunities for training and coaching. While some colleges reported a positive relationship with auditors, others perceive that auditors have a “gotcha” mentality. Colleges stated that they want to be accountable, but want a more collaborative working relationship with the System Office to understand how to meet accountability expectations.

### Legislative Recommendations

**Amend G.S. 115D-5(m).** The Program Audit Study Committee recommends that G.S. 115D-5(m) not be repealed effective July 1, 2015, but rather amended to codify the following key reforms (see Appendix E for draft legislation):

- To emphasize that the System’s accountability function needs to be significantly revised, the terminology of “program auditing” should be replaced with “compliance reviews”.
- Instead of annual audits, compliance reviews should be conducted periodically according to rules adopted by the State Board of Community Colleges.
- The statutory purpose of compliance reviews should specifically focus on the accuracy of the data used to allocate State funds among colleges and ensuring that colleges are charging and waiving tuition and registration fees consistent with law.
- The State Board should adopt rules governing the scope of what compliance reviews should include to fulfill this statutory purpose.
- Compliance review reports should include findings that meet the standard for materiality established by the State Board.

**Restore Recurring Funding.** The Program Audit Study Committee recommends that the General Assembly restore recurring funds to support an accountability function under the State Board of Community Colleges that is specifically focused on promoting the integrity of the System’s budget allocation process. The accountability function would be accomplished by:

- Providing periodic, objective assessments – on campus and, as IT functionality is developed, using technology where applicable – of college compliance with State laws and State Board rules governing the reporting of data used as the basis of college budget allocations as well as the charging and waiving tuition and registration fees; and
- Coaching colleges on areas of potential risk through sharing information on trends in compliance review findings, good documentation practices, and use of mitigating controls.

This accountability function is necessary to ensure the credibility of the System’s formula budget requests to the General Assembly and the fair allocation of State resources among the 58 institutions. An accountability function under the State Board is best positioned to provide consistent assessments of college compliance with State laws and State Board rules and to ensure colleges receive consistent guidance and support on compliance.

### **State Board Policy Recommendations**

**Simplify and clarify FTE rules.** The Program Audit Study Committee recommends that the State Board revise its policies to ensure rules for reporting FTE are current, clear, and simplified. The Committee has concluded that continuing to calculate FTE based on the literal number of instructional minutes is unnecessarily complex and inherently contrary to two key educational trends: online instruction and competency-based education.

Further, the Committee recommends that FTE rules be revised to calculate FTE based on a standard number of instructional units prescribed by the State Board for each course in the Combined Course Library, our System’s centralized and standardized list of approved courses. These revised rules should also establish clear policies for calculating FTE in situations where this methodology is not academically appropriate or adequately flexible to meet workforce development needs of local industry. These FTE rules should be codified in Title 1, Chapter G of the State Board of Community Colleges Code (SBCCC) effective no later than August 1, 2016.

The State Board should also clarify a number of other rules that are directly related to accurate reporting of FTE, including:

- **1A SBCCC 300. College Service Areas:** The counties that constitute each college’s service area should be codified in the SBCCC. The current policy simply states that the State Board shall assign service areas to colleges for providing education and training services.
- **1D SBCCC 200. Basic Skills, 300 Continuing Education, and 400 Curriculum:** These subchapters establish policies regarding education programs for which colleges earn FTE. These policies should be revised to ensure clarity, particularly with regards to enrollment/eligibility requirements, contracted instruction, education services to minors, and instructional service agreements (agreements under which colleges may provide instruction in another colleges’ service area).

**Adopt rules governing the accountability function.** The State Board should adopt a new subchapter of the SBCCC governing compliance reviews. Consistent with G.S. 115D-5(m) as proposed, these rules should address the frequency and scope of compliance reviews as well as adopt a standard for materiality. The State Board should also adopt rules establishing roles and responsibilities for on-going oversight of this accountability function.

As experience with the revised accountability function is gained and other relevant circumstances change, the State Board should review and revise these rules as it sees fit. However, the Program Audit Study Committee recommends including a number of specific concepts in the initial adoption of these rules.

- **Frequency:** Compliance reviews should be required every other year, unless a review has material findings or the college voluntarily requests an annual review, subject to the availability of resources.
- **Scope:** While the purpose of compliance reviews would be bound by G.S. 115D-5(m), the State Board should adopt rules to further define the scope of what documentation should be reviewed to fulfill that statutory purpose.
  - **Period of Review.** To improve timeliness, compliance reviews should cover the Summer, Fall, and Spring academic terms of the prior year for all instructional program areas (curriculum, continuing education, and basic skills). However, if a compliance review has material findings, the remedy (i.e. reversion of funds vs. adjustment of hours) may be different based on the timing of the review and program area.
  - **Review Components.** Using information available within the System Office as well as documentation provided by the college, the compliance examiners should ensure that the following conditions are true for each course section included in the review sample:
    - 1) The college is authorized by the State Board to provide the course;\*<sup>2</sup>
    - 2) The course is authorized to be reported for State funding;\*
    - 3) The course section is taking place in the college's service area or the appropriate instructional services agreement has been executed;\*
    - 4) The instruction is provided either through a college-employed instructor or through a third-party contract that complies with contracted instruction rules;
    - 5) The instruction provided to minors complies with State law;
    - 6) The number of instructional units reported per enrolled student is consistent with State Board rules;
    - 7) The college can demonstrate that each student for which instructional units are reported is a bona fide enrollee of the course as defined by the SBCCC; and
    - 8) The college either charged or waived the appropriate tuition or registration fee for each student consistent with State law.

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<sup>2</sup> \*These items are examples of conditions that would be evaluated using information available at the System Office.



- b. High Risk Areas. The sample of course sections should take into account risk. Initially, high risk areas should include (in priority order):
  - 1) Waived instruction,
  - 2) Online courses<sup>3</sup>, and
  - 3) Courses held at non-college facilities.
- c. Class Visits. The Committee recommends that compliance reviews only include class visits under two circumstances: 1) upon the request of the college president regarding a compliance review-related issue or 2) as part of a compliance review following up on material findings identified in a previous review. Colleges should continue to be required to conduct class visits of continuing education classes. The State Board should adopt rules to establish consistent minimum standards for conducting “internal” class visits, taking into account high risk areas. As part of the compliance review, compliance services staff should review class visit documentation to ensure colleges are complying with these internal class visit rules.

- 2. **Materiality**: The State Board should continue to require reversion of funds in any situation where fraudulent FTE is identified, regardless of the number of instructional units fabricated. However, the Committee recognizes that many issues identified through program audits are caused by human error, not malicious intent. Therefore, the State Board should adopt rules establishing a systemwide standard of materiality that acknowledges that a certain level of human error is inherent.

In contrast to the current standard of one FTE for all institutions, this materiality standard should somehow account for the size of the institution. For example, the standard could be based on a percentage of total instructional units or total State budget allocations. Reversion of funds would be required if a college exceeded the materiality threshold due to human error. The System Office should acquire outside expertise to help develop a recommendation on materiality. During the first compliance review cycle, error-related reversions should be suspended while this standard of materiality is being developed and tested.

- 3. **Oversight**: The State Board should adopt rules establishing a Compliance Review Advisory Committee. This Committee would be responsible for receiving college feedback about the compliance review process and making recommendations to the State Board on desired policy changes and to the System Office on desired procedural changes related to compliance reviews. These rules should prescribe Committee membership that represents relevant college constituencies (including college presidents, instructional administrators, continuing education administrators, and registrars), appointing authority, and terms. A representative from the Office of the State Auditor should be included as a non-voting member of the Committee to serve as a professional resource.

The Accountability and Audit Committee of the State Board would also have oversight responsibilities. Compliance Services staff should provide this Committee quarterly updates during FY 2015-16 on the status of implementing the recommendations included in this report. This State Board committee should also invite the Compliance Review Advisory Committee to

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<sup>3</sup> In this context, “online courses” is defined as a course that is offered 100% online.

provide feedback on their observations about the level of progress accomplished each quarter. Beyond the first year of implementation, the Accountability and Audit Committee should determine how frequently it would like to receive status reports from Compliance Services staff and the Compliance Review Advisory Committee on an on-going basis. The Audit and Accountability Committee should also continue to serve as the State Board committee that considers college appeals if financial reversions are assessed.

### **System Office Recommendations**

To support the implementation of this revised accountability function, the Program Audit Study Committee recommends that the System Office take the following actions:

**Develop recommendations for revising the State Board of Community Colleges Code:** To support the needed revisions to State Board policies, the System Office should collaborate with a committee of college representatives to draft proposed changes to the sections of the SBCCC discussed above. A committee should be established no later than January 31, 2015 to specifically work on a comprehensive rewrite of the rules related to calculating FTE. The timeline of the committee's work should be driven by the goal of having the State Board adopt new FTE rules effective no later than August 1, 2016.

Keeping State Board policies current is essential to a successful accountability process. Therefore, the System Office leadership should make periodic reviews and revisions to the SBCCC a top priority on an on-going basis.

**Clarify roles, responsibilities, and procedures for providing policy guidance to colleges:** Effective July 1, 2015, the accountability function should be renamed "Compliance Services". In addition to conducting periodic compliance reviews of colleges, the position descriptions for Compliance Services staff should be revised to include coaching colleges on areas of potential risk through sharing information on trends in compliance review findings, good documentation practices, and use of mitigating controls. The team will be responsible for developing and maintaining a comprehensive compliance review procedures manual that includes minimum standards as well as best practices for compliance documentation.

The qualifications for Audit Services staff should also be reviewed and revised to ensure team members have the requisite skills to meet these expectations. The qualifications of the Compliance Services Executive Director should include a preference for professional training in audit design and execution (i.e. CPA, Certified Internal Auditor, etc.). Team members' work plans should include participating in professional development activities, with an emphasis on deepening compliance examiners understanding of State Board policies and improving their ability to effectively communicate with colleges. Professional development should also include periodic (at least quarterly) team meetings focused on ensuring consistency of reviews.

A successful system of accountability, however, is not solely the responsibility of Compliance Services. Teamwork and communication across divisions within the System Office is essential. Appropriate programmatic staff should be assigned the responsibility of responding to questions regarding programmatic policy issues and, when appropriate, communicating policy guidance to all colleges via numbered memo.

If guidance provided via numbered memo is a policy interpretation or guidance on how to apply rules to situations not clearly addressed in the SBCCC, the numbered memo should be interim guidance until such time the State Board has clarified its rules. Likewise, programmatic staff must ensure procedures and guidance documents are up-to-date and readily accessible to colleges. Programmatic, Compliance Services, and IT staff should meet periodically to discuss compliance review findings and how policies, processes, communications, and training activities should be adjusted accordingly. To promote consistent understanding and communication with colleges, programmatic staff should also proactively share with Compliance Services staff the guidance they are providing colleges on issues relevant to compliance reviews.

**Acquire external expertise to provide guidance on sampling and materiality:** The statute requires the use of a statistically-valid sample for reviews. Based on an initial review of current sampling methods, the Program Audit Study Committee is concerned that this methodology may be causing auditors to “over-sample” – review more records than necessary – in some areas and potentially “under-sample” in others. Given the complexities of ensuring that a sample is statistically valid and accounts for risk, the System Office should acquire external expertise to provide guidance on how to pull a statistically valid, risk-based sample. This external expert should also provide advice on procuring or developing software to pull sound samples as well as advice on developing a systemwide materiality threshold.

**Change process for reviewing records, prioritizing the development of electronic-based processes:** To significantly reduce the administrative burden on both colleges and compliance examiners, the System Office should prioritize the development of systems and procedures to review college records electronically. While such processes are developed, compliance examiners should review official class and student records on campus and should cease the practice of reviewing these records off site.

As the revised FTE rules are developed in conjunction with the committee of college representatives, the System Office should work with that committee to also develop business requirements for needed IT functionality. These business requirements should be developed in consultation with System Office and college staff familiar with existing College Information System (CIS) functionality. Audit Services staff should also explore with a few volunteer pilot colleges whether there are records relevant to the audit review that can be responsibly accessed electronically at the local level.

### **Interim Transition Plan**

Implementation of the recommendations included in this report will necessarily occur in phases. The following provides an approximate timeline of the planned implementation activities over the next three years.

**Remainder of FY 2014-15:** Audit Services staff will continue to conduct statutorily mandated program audits for the remainder of the current fiscal year under revised procedures adopted by the State Board. Based on the Program Audit Study Committee input, the State Board made the following changes in August 2014:

- Removed audit review items that were not directly related to the calculation of FTE or tuition and registration fee waivers. Items removed included verification that the college local board of trustees discussed the college’s financial statement audit, the intercollegiate athletics review, and the curriculum pre-requisites review.

- Clarified that audit findings will only include direct violations of the General Statutes or the State Board of Community Colleges Code (SBCCC). Issues identified by auditors that pose potential risk, but for which the SBCCC is ambiguous or rules have not yet been adopted, will be documented in a management letter to the college president. Such issues will also be forwarded to the System Office Executive Vice President, who will in turn request the appropriate System Office division to recommend clarifying SBCCC language.

During the remainder of this fiscal year, System Office staff will continue developing draft revisions to the State Board of Community Colleges Code in consultation with college representatives and associations. Near-term milestones include:

- Establishing a committee and initiating work on the re-write of the FTE chapter of the SBCCC.
- Recommending to the State Board proposed changes to the Education Services chapter of the SBCCC.
- Starting the development of draft rules governing the future accountability function.

System Office staff will also continue to work on changing the organizational culture surrounding accountability. This change will be accomplished through on-going coaching of Audit Services staff and clarifying roles and responsibilities of auditors and programmatic staff. As these roles are clarified, revised job descriptions for Compliance Services staff will be developed.

Finally, issues related to sampling and materiality will be further explored with the assistance of outside expertise. Based on the high-risk areas identified previously, the System Office will look at how FTE data can be categorized to support more sophisticated risk-based statistical sampling. Likewise, staff will need to investigate how extrapolating errors found in statistical samples to the relevant populations should inform decisions about materiality. It is also recommended that the System Office contract with a professional with audit experience and expertise, such as a CPA, to provide leadership and guidance in the development of the new accountability function.

**FY 2015-16:** Assuming legislative action establishes an accountability function consistent with the recommendations of this report, compliance reviews would need to be suspended temporarily while the foundation of the new accountability system was rebuilt, with a goal of initiating the 2015-16 compliance review cycle in October 2015. During the period immediately after July 1, 2015, implementation activities would include:

- Reviewing Compliance Services staffing to identify any vacancies that need to be filled and skill deficits that need to be addressed;
- Finalizing the rules governing the new accountability function, consistent with the amended General Statute adopted by the General Assembly;
- Developing the compliance review schedule and interim procedures that would be followed until the FTE chapter of the SBCCC is revised;
- Finalizing the methodology for pulling a statistically-valid, risk-based sample; and
- Appointing of the Compliance Review Advisory Committee.

Throughout the first year of implementation, work on SBCCC revisions would be on-going. The top priority would be finalizing recommended changes to the FTE Chapter of the SBCCC so that the State Board could initiate rule-making in the spring of 2016.

As noted previously, Compliance Services staff would provide quarterly updates to the State Board regarding the status of implementation activities throughout FY 2015-16, and the Compliance Review Advisory Committee would be invited to provide independent feedback on implementation progress.

Also, once the System Office establishes the foundation of the revised accountability system and gains some experience conducting compliance reviews, the budget for Compliance Services will be revisited. If it is possible to conduct compliance reviews less expensively than originally planned, the economies should be redirected to other priorities or offered as a future budget reduction option.

**FY 2016-17 and beyond:** With the adoption of new FTE rules expected in August 2016, Compliance Services staff would need to revise its procedures to conform to these new rules for the following year's compliance review cycle. To accompany these new procedures, a detailed Compliance Review Procedures Manual should be developed for college staff use. To ensure this manual is clear and meets the needs of the colleges, it should be developed in consultation with a focus group of college staff directly involved the compliance review process.

Once revised rules are in place, attention should also shift to developing a plan for conducting compliance reviews electronically. Compliance Services staff should work with a few volunteer pilot colleges to determine whether accessing electronic records at the local level is a viable option that should be considered. If not, the plan should focus on documenting the business requirements for IT functionality needed at the State level. This plan should also identify any policy, cultural, or other non-technological barriers to achieving electronic compliance reviews.

At the conclusion of the first compliance review cycle, the State Board should revisit its threshold of materiality in light of the experience gained through the completed review cycle to determine if changes are appropriate. Starting with the 2017-18 compliance review cycle, financial reversions should be assessed for colleges whose findings due to human error exceed this materiality threshold.

**Appendix A: Summary of Proposed Accountability System Reforms**

<b>CURRENT</b>	<b>PROPOSED</b>
<p><b>SBCCC Title I, Chapter G. Full-Time Equivalent (FTE)</b></p> <ul style="list-style-type: none"> <li>FTE are currently calculated based on the literal number of hours and minutes of instruction provided.</li> </ul>	<ul style="list-style-type: none"> <li>To significantly simplify FTE calculations, calculate FTE based on a standard number of instructional units for a defined amount of instructional content (i.e. a class), where possible.</li> </ul>
<p><b>Purpose of Audits</b></p> <ul style="list-style-type: none"> <li>Per G.S. 115D-5(m): “The purpose of the annual audit shall be to ensure that college programs and related fiscal operations comply with State law, State regulations, State Board policies, and System Office guidance.”</li> </ul>	<ul style="list-style-type: none"> <li>Amend G.S. 115D-5(m) to state: “The purpose of the compliance review shall be to ensure that data used to allocate State funds among colleges is reported accurately to the System Office and that colleges are charging and waiving tuition and fees consistent with law.”</li> </ul>
<p><b>Frequency</b></p> <ul style="list-style-type: none"> <li>Per G.S. 115D-5(m), program audits are required to be conducted annually for all 58 colleges.</li> </ul>	<ul style="list-style-type: none"> <li>The State Board would adopt rules governing the frequency of compliance reviews.</li> <li>Initially conduct compliance reviews every other year, unless a review has material findings or the college voluntarily requests an annual review.</li> </ul>
<p><b>Materiality</b></p> <ul style="list-style-type: none"> <li>Reversion of funds is required when the sum of the curriculum instructional hours with identified issues exceeds 512.</li> <li>Reversion of funds is required when the sum of the non-curriculum instructional hours with identified issues exceeds 688.</li> </ul>	<ul style="list-style-type: none"> <li>Adopt rules establishing a systemwide standard of materiality that acknowledges a certain level of error is inherent and considers errors in context of college size.</li> <li>Require reversion of funds when the sum of instructional hours with identified issues exceeds a certain percentage of total instructional hours.</li> <li>Continue to have zero-tolerance policy on fraudulent FTE.</li> <li>Suspend error-related reversions during the first compliance review cycle while standard of materiality is being developed and tested.</li> </ul>
<p><b>Scope of Audits</b></p> <ul style="list-style-type: none"> <li>The scope of what program audits specifically review in a given year has sometimes changed, and it is unclear what formal process should be followed to make such changes.</li> </ul>	<ul style="list-style-type: none"> <li>Adopt rules that establishes what compliance reviews will specifically review to fulfill the statutory purpose.</li> <li>If it is necessary in the future to change the specific items of review to fulfill the statutory purpose, the State Board would have to go through the rule-making process to make those changes.</li> </ul>
<p><b>Class Visits</b></p> <ul style="list-style-type: none"> <li>Program auditors currently conduct class visits.</li> </ul>	<ul style="list-style-type: none"> <li>Compliance examiners would not conduct class visits unless specifically requested by the college president or as part of a compliance review following up on material findings.</li> </ul>

	<ul style="list-style-type: none"> <li>Colleges would be required to meet State Board-established minimum standards for conducting “internal” class visits for continuing education classes.</li> </ul>
<b>Review Method</b> <ul style="list-style-type: none"> <li>Current process is paper-intensive.</li> <li>Program auditors usually take records off campus for review.</li> </ul>	<ul style="list-style-type: none"> <li>Change process so that no class/student records are removed from campus for review.</li> <li>Prioritize the development of electronic-based compliance review processes. Develop business requirements for needed IT functionality in conjunction with development of revised FTE rules.</li> </ul>
<b>Period of Review</b> <ul style="list-style-type: none"> <li>Audit covers period of prior budget FTE “counting period” <ul style="list-style-type: none"> <li>CU: Summer, Fall, Spring (for example, an audit conducted in 2013-2014 would review 2012-13 academic year and prior summer)</li> <li>CE: Spring, Summer, Fall (for example, an audit conducted in 2013-2014 would review 2012 calendar year)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>To improve timeliness, compliance reviews should cover the Summer, Fall, and Spring academic terms of the prior year for all instructional program areas (curriculum, continuing education, and basic skills).</li> <li>However, if a compliance review has material findings, the remedy (i.e. reversion of funds vs. adjustment of hours) may be different based on the timing of the review and program area.</li> </ul>
<b>Sampling</b> <ul style="list-style-type: none"> <li>Current sampling method may be causing auditors to “over-sample” (i.e. review more records than necessary).</li> <li>Current sampling method needs to be revisited to meet statutory requirement for being statistically valid.</li> </ul>	<ul style="list-style-type: none"> <li>Acquire external expertise to provide guidance on how to pull a statistically valid, risk-based sample.</li> <li>Determine whether the number of records reviewed can be reduced and the sample remain valid.</li> </ul>
<b>Oversight</b> <ul style="list-style-type: none"> <li>The State Board Accountability and Audit Committee hears college appeals and reports on program audit activity.</li> <li>The Program Audit Task Force discusses and tries to resolve specific audit concerns identified by colleges.</li> </ul>	<ul style="list-style-type: none"> <li>Adopt rules establishing a Compliance Review Advisory Committee consisting of college representatives.</li> <li>Document the role of State Board Accountability and Audit Committee regarding compliance reviews, including continued review of college appeals.</li> </ul>
<b>Roles and Responsibilities</b> <ul style="list-style-type: none"> <li>Program auditors have historically answered college questions that require policy interpretations.</li> </ul>	<ul style="list-style-type: none"> <li>Programmatic staff would have the authority and responsibility to provide policy guidance to colleges and identify when SBCCC changes are necessary to ensure policy clarity.</li> <li>Compliance staff would follow interpretations made by programmatic staff.</li> </ul>
<b>Accountability System Name</b> <ul style="list-style-type: none"> <li>Colleges undergo “program audits” conducted by “auditors” in the “Audit Services Section” of the System Office.</li> </ul>	<ul style="list-style-type: none"> <li>To underscore that the System’s accountability function is being reimagined, colleges would undergo “compliance reviews” conducted by “compliance examiners” in the “Compliance Services Section” of the System Office.</li> </ul>

**Appendix B:  
2013 Legislation Regarding Program Audits**

**Section 10.15 of S.L. 2013-360:**

**CLARIFY COMMUNITY COLLEGE AUDITS**

**SECTION 10.15.(a)** Effective July 1, 2015, G.S. 115D□5(m) is repealed.

**SECTION 10.15.(b)** G.S. 115D□58.16 reads as rewritten:

**"§ 115D□58.16. Audits.**

(a) Each community college shall be audited subject to a financial audit a minimum of once every two years. Community colleges may use State funds to contract with the State Auditor or with a certified public accountant to perform the audits. The colleges shall submit the results of the audits to the State Board of Community Colleges.

The State Board of Community Colleges shall ensure that all colleges are audited in accordance with this section.

(b) Notwithstanding the provisions of Chapter 143D of the General Statutes, a community college shall not be subject to the EAGLE program administered by the Office of the State Controller unless (i) there is a finding of internal control problems in the most recent financial audit of the college or (ii) the State Board of Community Colleges determines that a college should be subject to the program."

**SECTION 10.15.(c)** A study of the program audit function under G.S. 115D□5(m) shall be conducted by a committee, located administratively in the Community Colleges System Office, composed of the following 12 members:

- (1) The Community Colleges System Office Chief Financial Officer.
- (2) Three State Board of Community College members appointed by the chair of the State Board of Community Colleges.
- (3) Three college presidents appointed by the North Carolina Association of Community College Presidents.
- (4) Three college board of trustee members appointed by the chair of the North Carolina Association of Community College Trustees.
- (5) The State Chief Information Officer or designee.
- (6) The State Auditor or designee shall serve as a nonvoting member.

The Community Colleges System Office Chief Financial Officer shall chair the committee. The committee shall meet upon the call of the chair. A quorum of the committee shall be a majority of the members.

The committee shall determine how program audit procedures may be streamlined to minimize the administrative burden on the institutions being audited and how funding mechanisms may be changed to reduce reliance on contact hours. The committee shall seek input from community college staff members who are responsible for assistance with the program audits to study the problems associated with the program audit function and potential resolutions for those issues. The committee shall report the results of its study and recommendations to the Joint Legislative Education Oversight Committee by January 1, 2015.

**Section 3.14 of S.L. 2013-363**

**SECTION 3.14.** If Senate Bill 402, 2013 Regular Session, becomes law, then Section 10.15(c) of that act reads as rewritten:

**"SECTION 10.15.(c)** A study of the program audit function under G.S. 115D□5(m) shall be conducted by a committee, located administratively in the Community Colleges System Office, composed of the following 12 members:

- (1) The Community Colleges System Office Chief Financial Officer shall serve as a nonvoting member.
- (2) Three State Board of Community College members appointed by the chair of the State Board of Community Colleges.
- (3) Three college presidents appointed by the North Carolina Association of Community College Presidents.
- (4) Three college board of trustee members appointed by the chair of the North Carolina



Association of Community College Trustees.

(5) The State Chief Information Officer or designee shall serve as a nonvoting member.

(6) The State Auditor or designee shall serve as a nonvoting member.

The Community Colleges System Office Chief Financial Officer shall chair the committee. The committee shall elect a chair from its members. The committee shall meet upon the call of the chair. A quorum of the committee shall be a majority of the members.

The committee shall determine how program audit procedures may be streamlined to minimize the administrative burden on the institutions being audited and how funding mechanisms may be changed to reduce reliance on contact hours. The committee shall seek input from community college staff members who are responsible for assistance with the program audits to study the problems associated with the program audit function and potential resolutions for those issues. The committee shall report the results of its study and recommendations to the Joint Legislative Education Oversight Committee by January 1, 2015."

**Joint Conference Committee Report on the Continuation, Expansion, and Capital Budgets (July 21, 2013), page F-9, Item 54:**

	<b>FY 2013-14</b>	<b>FY 2014-15</b>
<b>54 Audit Services</b>		
Eliminates recurring funding for the Audit Services division c	(\$551,572) R	(\$551,572) R
System Office. Restoration of recurring funding is subject to		
results of a study by the State Board of Community Colleg	\$551,572 NR	\$551,572 NR
accordance with Section 10.15 of this act.		

**Appendix C:  
Program Audit Task Force Membership**

<b>Committee Member</b>	<b>College Representing</b>	<b>Area Representing</b>
Kay Albertson	Wayne CC	Presidents
Ken Boham	Caldwell CC&TI	Presidents
Steve Thornburg	Cleveland CC	Presidents
Mark Kinlaw	Robeson CC	Instructional Administrators
Amanda Lee	Cape Fear CC	Instructional Administrators
Kim Gold	Isothermal CC	Instructional Administrators
Sharon McGinnis	Coastal Carolina CC	Continuing Education
Carol Johnson	Mitchell CC	Continuing Education
Doris Carver	Piedmont CC	Continuing Education
Scott Douglas	Asheville-Buncombe TCC	Registrars
Barbara Boyce	System Office	Continuing Education
Jennifer Haygood	System Office	Ex VP/CFO
Jennifer Frazelle	System Office	Academic Programs
Bryan Jenkins	System Office	Director of Internal Auditing
Elizabeth Self	System Office	Administration

**Appendix D:  
Regional Accountability Listening Session Agenda**

1. Welcome
2. Introductory Remarks from Program Audit Study Committee Members in Attendance
3. Purpose of Listening Session – Jennifer Haygood
4. Group Discussion
  - a. State Board Code
    - What rules or policies do you feel are particularly outdated, unclear, or inadequate?
    - What are some examples of times when you have been told that colleges can or cannot do something, but you don't understand why you've been told that?
    - Do you have ideas on how any specific rules or policies should be revised?
    - Example Discussion Topic: Reporting hours for non-traditional courses
  - b. Training and Communication
    - What type of training would colleges like to receive on rules and policies?
    - How could the System Office improve communication related to rules and policies?
  - c. Documentation
    - How much guidance do colleges want about good documentation practices?
    - Do you have any specific ideas on how colleges could document compliance with rules and policies in a less burdensome manner?
    - Example Discussion Topic: Career and College Promise student eligibility
  - d. Other participant concerns/feedback

**Appendix E:  
Recommended Legislation**

**ACCOUNTABILITY FUNCTION**

**Section X.(a).** Section 10.15.(a) of S.L. 2013-360 is repealed.

**Section X.(b).** G.S. 115D-5(m) reads as rewritten:

“(m) The State Board of Community Colleges shall maintain an education program auditing accountability function that conducts ~~an annual audit~~ periodic reviews of each community college operating under the provisions of this Chapter. The purpose of the ~~annual audit~~ compliance review shall be to ensure that ~~college programs and related fiscal operations comply with State law, State regulations, State Board policies, and System Office guidance~~ data used to allocate State funds among colleges is reported accurately to the System Office and that colleges are charging and waiving tuition and registration fees consistent with law. The State Board of Community Colleges shall require ~~auditors of community college programs to~~ the use of a statistically valid sample size in performing ~~program audits~~ compliance reviews of community colleges. All ~~education program audit~~ compliance review findings that are material shall be forwarded to the college president, local college board of trustees, the State Board of Community Colleges, and the State Auditor. The State Board shall adopt rules governing the frequency, scope, and standard of materiality for compliance reviews.”

**Section X.(c).** This section is effective July 1, 2015.