

Minutes of the March 6, 2008 Meeting
of the Board of Governors' Audit Committee

The Audit Committee met in the Woolworth Room of the John Friedrick Educational Technology Complex at North Carolina School of Science and Mathematics in Durham, North Carolina on Thursday, February 6, 2008, at 4:30 p.m.

Members in attendance were Dr. Laura W. Buffaloe, Mr. Frank Daniels, Jr., Mr. G. Leroy Lail, Mr. Charles H. Mercer, Jr., and Mr. William G. Smith. Necessarily absent were Mr. David W. Young and Mr. Craig Souza. Others attending the meeting were Associate Vice Presidents David King and James O. Smith. Also in attendance were Chancellor Kenneth E. Peacock (ASU) and Ms. Katie Collini, Internal Auditor (NCSSM).

Chair Smith welcomed everyone to the meeting and introduced Ms. Katie Collini of the North Carolina School of Science and Mathematics. On the motion of Dr. Buffaloe, seconded by Mr. Lail, the agenda was approved.

On the motion of Mr. Lail, seconded by Dr. Buffaloe, the minutes of February 7, 2008 were approved.

Mr. King briefed the committee on the 2007 financial audit reports and 2007 investigative report released since the last meeting.

1. The University of North Carolina at Greensboro: – (Financial Audit): No Audit Findings
Report URL:
<http://www.ncauditor.net/EpsWeb/Reports/Financial/FIN-2007-6040.pdf>
2. North Carolina State University: – (Financial Audit): No Audit Findings
Report URL:
<http://www.ncauditor.net/EpsWeb/Reports/Financial/FIN-2007-6030.pdf>
3. The University of North Carolina at Charlotte: – (Financial Audit): One Audit Finding
Report URL:
<http://www.ncauditor.net/EpsWeb/Reports/Financial/FIN-2007-6050.pdf>

Matters Related to Financial Reporting Objectives

The following audit finding was identified during the current audit and describes conditions that represent significant deficiencies in internal control.

DEFICIENCIES IN FINANCIAL REPORTING

The notes to the financial statements prepared by the University had several misstatements. Although the errors were relatively small in relation to the financial statements taken as a whole, they are indicative of an increased risk that future financial statements may be misleading to readers should there be any further weakening of the financial reporting process. Misstatements noted in our audit included:

The Statement of Cash Flows contained offsetting errors of \$8,244,640. Cash Flows from Noncapital Financing Activities were understated when deficit Other Payments were presented. Cash Flows from Investing Activities were overstated when Investment Income was overstated.

The total cash reported in the Deposits note was overstated by \$2,191,995. The cash on hand and cash held in private bank accounts were reported twice, once as cash on hand and cash in private bank accounts and once as part of the equity in the State Treasurer's Short-Term Investment Fund.

The Endowment Investments note contained two misstatements. The net appreciation available to be spent was overstated by \$898,432, and the amount restricted to specific purposes was overstated by \$1,121,485.

The Receivables note erroneously included \$1,823,857 that was due from Primary Government and \$168,815 due from University Component Units. These amounts are reported on the Statement of Net Assets in individual account captions, and thus, are not part of the detail comprising the Receivables account disclosed in the note.

Recommendation: The University should place greater emphasis on the year-end financial reporting process and implement effective internal controls to ensure the accuracy of the financial statements and related notes.

University's Response: Management agrees with this recommendation and will allocate additional resources and implement additional internal controls to ensure that financial statements and the accompanying footnotes are in agreement and are accurate.

4. **North Carolina Central University:** – (Investigative Audit): Six Audit Findings

Report URL:

<http://www.ncauditor.net/EpsWeb/Reports/Investigative/INV-2008-0330.pdf>

See Attachment 2

5. **The University of North Carolina at Wilmington:** – (Financial Audit): Four Audit Findings

Report URL:

<http://www.ncauditor.net/EpsWeb/Reports/Financial/FIN-2007-6060.pdf>

Matters Related to Financial Reporting or Federal Compliance Objectives

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements or other matters.

TIME AND EFFORT CERTIFICATIONS NOT COMPLETED TIMELY

The University did not have controls in place to ensure that time and effort certifications were completed within the required time frames. Time and effort certifications are used to confirm that the percentage of salary charged to a grant matches the percentage of time that the employee actually expended on that grant. The risk that grants will not be properly charged increases when time and effort certifications are not completed timely.

At the beginning of our audit in August 2007, we learned that the time and effort reports had not been completed for the 2006-2007 year. After our inquiry, the certifications were sent out for both semesters of the year. Salary costs charged to the Research and Development Cluster approximated \$3 million for the fiscal year ending June 30, 2007.

The federal cost principle (OMB Circular A-21 Section 1.10) requires institutions to develop a mechanism to determine or confirm how individuals actually expend effort during a specified time period. These effort reports must be performed on a regular schedule and must be certified by individuals who have first-hand knowledge of 100 percent of the employee's compensated activities. These reports are to be prepared at least every six months. In addition, the University's policy states "To meet audit standards, the certificate (time and effort form) must account for 100 percent of the employee's work and be submitted each semester.

Recommendation: We recommend the University strengthen controls to ensure compliance with federal cost principles and with its policy concerning time and effort reporting.

University Response: The University of North Carolina at Wilmington Office of Sponsored Program will strengthen controls to ensure compliance with federal cost principles and with its policy concerning time and effort reporting.

CONTROLS OVER FEDERAL DEBARMENT VERIFICATION NEED IMPROVEMENT

The University did not have controls in place to ensure that covered transactions (contracts and procurements in excess of \$25,000) were made only to vendors that were eligible to participate in federal programs. Our tests of 17 vendor payments over \$30,000 in the Research and Development Cluster (ES-14882-05-55, award period July 1, 2006 - June 30, 2007) disclosed that the University had not verified the federal debarment status for any of the vendors tested. None of the vendors involved were currently debarred and there were no questioned costs. Inadequate controls increase the risk that contracts could be made with debarred or suspended parties resulting in questioned costs.

Title 2 CFR sections 180.220 and .300 require verification for procurement transactions, expected to equal or exceed \$25,000, to ensure that the recipients of federal funds are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System maintained by the General Services Administration, collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity.

Recommendation: The University should establish and implement procedures to ensure compliance with federal suspension and debarment regulations.

University Response: The University has established and implemented procedures between the Purchasing Department and the Office of Sponsored Programs to ensure compliance with federal suspension and debarment regulations.

ESTIMATED USEFUL LIFE OF CAPITAL ASSETS NEEDS TO BE RE-EVALUATED

The University did not fully re-evaluate its machinery and equipment capital assets that were fully depreciated or were approaching the end of their useful lives. Because depreciation is a method of allocating an asset's cost over its useful life, a periodic review of the useful life is necessary for depreciation to reflect that allocation. The University reported total Machinery and Equipment of \$29.9 million at June 30, 2007, and \$11 million of this total was fully depreciated.

We examined a sample of fully depreciated capital assets with cost of \$4 million and found that \$2.1 million were still in service, functioning as designed, and expected to remain in service for an unknown period of time. Extending the useful lives of the fully depreciated assets by 2 - 10 years based on the asset classification, we estimated that the accumulated depreciation was overstated by approximately \$3.3 million.

Recommendation: The University should implement additional procedures to ensure that the useful lives of capital assets are periodically re-evaluated and to ensure that assets still in service are not fully depreciated.

University Response: The University of North Carolina at Wilmington will continue to strengthen procedures to ensure that the useful lives of capital assets are periodically reevaluated and to ensure that assets still in service are not fully depreciated.

FINANCIAL STATEMENTS NOT PREPARED TIMELY

The University did not have adequate controls in place to ensure its financial statements were completed and submitted within required time frames as prescribed by the Office of State Controller. The completion of financial statements in a timely manner will ensure compliance with representations made to the Office of State Controller and prevent delays in the audit process.

Per the Office of State Controller's Memorandum SAD 04-22, all component units of the State of North Carolina that are audited by the State Auditor will disclose in their letter of representation that the formal financial statements, the formal notes to the financial statements, the management's discussion and analysis, and required supplementary information (if applicable) prepared in accordance with GAAP will be made available to the State Auditor by September 30 of each year. The University, in its letter dated August 31, 2007, represented to the Office of State Controller that the financial statements would be completed and available for audit on or before September 30, 2007. However, on October 24, 2007, the University had not submitted the management discussion and analysis component and statement of cash flows component of the University's financial statements. Other required components were completed timely.

Recommendation: The University should establish and implement procedures to ensure that completed financial statements are available for audit by September 30 of each year.

University Response: The University met all deadlines for timely completion for the formal financial statements, formal notes and supplementary information to the Office of State Controller. Upon completion of our final entries and affirmation from the Office of State Controller that our financial statements were completed, we promptly sent our transaction file to the State Auditor's Office prior to receiving a formal request. We also made available a preliminary copy of our financial statements to the state auditors for their review to determine materiality thresholds in early September. This prompt action on the University's part was to aid the state auditors to be able to proceed with their audit as they were currently on campus and in the middle of their audit. Although our letter of representation does indicate that we will make available to the state auditors our formal financial statements, it has been our practice with the state auditors to provide the Management Discussion and Analysis and the Statement of Cash Flows as needed in their audit review. This repetitive common practice became the accepted deadline with the state auditors. Although the formal Management Discussion and Analysis was not provided to the state auditors by September 30, the management discussion and analysis worksheet had been completed and sent to the Office of State Controller by August 31.

The University will change its practice in the future to provide the formal financial statements by the established deadlines to the Office of State Auditors.

Each of the above institutions was placed on a 90-day count to implement corrective actions. Mr. King would provide an update at the next committee meeting. Questions were answered throughout the briefing.

Then, Mr. King explained to the committee the North Carolina Office of the State Controller's new internal control program, EAGLE (Enhancing Accountability in Government through Leadership and Education), which was established to meet the requirements of House Bill 1551 Chapter 143D "State Governmental Accountability and Internal Control Act."

The responsibilities of the EAGLE program were to establish standards, policies and procedures as well as provide training courses, materials and other information sources to ensure a strong and effective system of internal control over financial reporting within state government. Training for the 17 institutions and UNC-GA had been scheduled into two groups:

Group One – March 2008

Appalachian State University
East Carolina University
North Carolina State University
The University of North Carolina at Chapel Hill
The University of North Carolina at Greensboro

Group Two – Fall 2008

Elizabeth City State University
Fayetteville State University
North Carolina A&T State University
North Carolina Central University
North Carolina School of the Arts
North Carolina School of Science and Mathematics
The University of North Carolina at Asheville
The University of North Carolina at Charlotte
The University of North Carolina at Pembroke
The University of North Carolina at Wilmington
Western Carolina University
Winston-Salem State University
The University of North Carolina – General Administration

Mr. King had attended two meetings to date. Questions were answered throughout the discussion.

There being no further business, the meeting was adjourned.

Mr. William G. Smith
Chair of the Audit Committee

Dr. Laura W. Buffaloe
Secretary of the Audit Committee

**NORTH CAROLINA CENTRAL UNIVERSITY
FINDINGS AND RECOMMENDATIONS
SPECIAL REVIEW
FEBRUARY 2008**

1. THE ASSISTANT PROVOST IMPROPERLY AUTHORIZED PAYMENTS OF FEDERAL GRANT FUNDS.

The Assistant Provost inappropriately authorized graduate assistant contracts and honoraria² for unauthorized individuals. The table below shows payments to these individuals who never performed the associated duties.

An undergraduate student indicated the Assistant Provost directed her to cash a University check, keep \$500, and pay the balance to him so the Assistant Provost could make payments on his credit card. She also indicated the Assistant Provost asked her to obtain Social Security numbers from other individuals. She said she provided those numbers to the Assistant Provost and he subsequently provided her with University checks made out to these individuals. She indicated the Assistant Provost directed her to ask the individuals to cash the checks and return most of the funds to him. One of these individuals stated he cashed two \$2,000 checks, kept \$500 from the first check and \$250 from the second check, and returned the balance to the student.

University payments authorized by the by Assistant Provost			
Type	Amount Authorized	Amount Cashed	Date
<i>Graduate Assistantship</i>			
	\$2,964	\$2,964	August 2003
	18,700	0	September 2003
Subtotal	\$21,664	\$2,964	
<i>Honorarium</i>			
	\$2,377	\$2,377	April 2003
	\$2,000	\$2,000	October 2003
	\$2,000	\$0	October 2003
	\$2,000	\$2,000	October 2003
	\$2,000	\$2,000	March 2004
	\$2,000	\$2,000	March 2004
	\$2,000	\$2,000	March 2004
Subtotal	\$14,377	\$12,377	
Total	\$36,041	\$15,341	

² An honorarium is a payment given to a professional person for services for which fees are not legally or traditionally required.

FINDINGS AND RECOMMENDATIONS (cont'd)

Other individuals receiving unauthorized payments were the Assistant Provost's nephew and the nephew's girlfriend. The girlfriend said the Assistant Provost's nephew told her the University owed him money for lawn services and a University check was written in her name because he had misplaced his identification card. She said the two of them collected the check written to her and cashed it at a check cashing company.

In summary, we found nine payments, totaling \$26,041, improperly authorized by the Assistant Provost. Seven of these payments were cashed with a total value of \$15,341. Two remaining payments valued at \$20,700 were authorized or issued but never cashed. All of these improper expenditure authorizations were from United State Department of Health and Human Services funds associated with the Minority Biomedical Research Support and the Overcoming Racial Health Disparities grants.

We also reviewed the 2003 and 2004 statements of the credit card issued to the Assistant Provost by the University. We found delinquency charges, a notice of account cancellation, and a notice to assign the account to a collection agent. These findings lend credibility to the complainant's assertion that the Assistant Provost's actions were taken to help make his credit card payments.

Recommendation: The University should implement administrative controls to ensure funds are used according to federal, state, and local funding statutes and procedures. A review of the payment authorization and grant administration process should also be performed. The University should immediately begin procedures requiring the repayment of these funds by the Assistant Provost.

Note: Finding will be referred to the US Attorney's Office Middle District, District Attorney for North Carolina Judicial District 14 and the North Carolina State Bureau of Investigation.

Response: The University will review its procedures to ensure that we are in compliance with federal and state regulations and where appropriate, make the necessary adjustments to further reduce the possibility of fraud. Consistent with state statutes, the University will require the Assistant Provost to repay the funds.

2. DOCUMENTS RELATED TO IMPROPER PAYMENTS WERE FALSIFIED AND DID NOT CONTAIN THE APPROPRIATE APPROVALS.

We found two employment forms initiated by the Assistant Provost for an unqualified student that contained false authorization signatures. One of the signatures required on these forms is from the Scholarships and Financial Aid Office which verifies student enrollment in the graduate school. The Assistant Director of the Scholarships and

Financial Aid Office said her signature was falsified on these forms. The potential payments on the graduate assistant contracts were \$21,664. The Director of the Scholarships and

FINDINGS AND RECOMMENDATIONS (cont'd)

Financial Aid Office believed the contracts were not reviewed by the Scholarships and Financial Aid Office. Based on the statements from the Assistant Director, it appears an attempt was made to bypass the Scholarships and Financial Aid Office by false pretense.

We also found documentation used to authorize honoraria payments that included false information. The University's honorarium authorization form requires the recipient's "name, occupation and title, if any." Our review revealed that none of the businesses named on the forms had employed the individuals named. Three of the forms stated the individuals had "Dr." as their title. When asked about this title, none of these individuals said they held a doctoral degree. A letter found in the University's records was addressed to the Assistant Provost from one of the individuals who received payment. The individual indicated she had never seen the letter and was misrepresented as having a doctoral degree and having the title "Director of the Centre for Biodiversity and Conservation Biology." She also said the signature on the letter was not her signature. The honoraria forms containing false information were approved solely by the Assistant Provost.

Additionally, we reviewed the approvals on other graduate assistant contracts originating with the Assistant Provost. We determined five of 20 of the graduate assistant contract authorization forms did not have sufficient written approvals. These contracts required approvals from the Principal Investigator, the Dean of the student's college, the Contracts and Grants (or Budget) administrator, the Comptroller, an officer from the Scholarships and Financial Aid Office, and the Vice-Chancellor for Academic Affairs. No written procedure was available to identify which signatures were required, or who was responsible to verify that all required signatures are included. In addition, the Assistant Provost signed three of the 20 forms both as the originator and, on behalf of the Provost, as the final approver. This bypasses the internal control that requires the Provost's additional approval.

Recommendation: The University should continue to coordinate with appropriate law enforcement authorities to determine whether the Assistant Provost's conduct constitutes a violation of North Carolina General Statutes or other regulation or law. In addition, the University should take appropriate disciplinary action against the Assistant Provost, which should include restitution.

The University should also implement administrative controls to ensure proper authorization of graduate assistant contracts, so that such egregious misconduct of position, if not criminal wrongdoing, is not repeated. All University policies and procedures that address accountability should be relevant, adequate and, if appropriate, available in electronic format for ease of access. The latest revision dates should be clearly stated on the policies and procedures.

FINDINGS AND RECOMMENDATIONS (cont'd)

Note: Finding will be referred to the US Attorney's Office Middle District, District Attorney for North Carolina Judicial District 14 and the North Carolina State Bureau of Investigation.

Response: The University's Campus Police is conducting a thorough review and continues to work with appropriate law enforcement officials. Additionally, the University will undertake a review of current procedures and strengthen, where appropriate, to further reduce the possibility of fraud.

3. THE ASSISTANT PROVOST VIOLATED UNIVERSITY POLICY BY NOT REPORTING AN IMPROPER RELATIONSHIP IN A TIMELY MANNER.

According to the Assistant Provost and a student, a personal, indeed amorous, relationship between these two individuals began in 2003. Although this relationship began in 2003, the Assistant Provost did not report it to University officials until December 2006. This violates the University's Policy Concerning Improper Relationships Between Students and Employees stating, "Whenever a situation creates or appears to create a conflict of interest under the policy, the faculty member or other employee involved shall report it promptly to his/her Director, Special or Executive Assistant to the Chancellor, Department Head, Department Chairperson, Dean, Vice Chancellor, or, in the case of employees who report directly to the Chancellor, to the Chancellor."

The student with whom the Assistant Provost had an amorous relationship was offered two graduate assistant contracts, one beginning August 2003 and the other beginning September 2003. These contracts were authorized and approved by the Assistant Provost. The first contract was a one-month agreement for \$2,964 to perform research and was charged to the Overcoming Racial Health Disparities grant. The student stated she never worked at the University, although the Assistant Provost allowed payment to the student and approved her Time and Effort Report. The second contract, a one-year agreement for \$18,700, was rejected by a University official.

Authorization of payment for work not performed is an example of the Assistant Provost's abuse of power that was precipitated by an amorous relationship between the Assistant Provost and the student. The University's Policy Concerning Improper Relationships Between Students and Employees was violated because the relationship was not self-reported in a timely manner and because of the abuse of power and the misconduct that ensued. The effect of noncompliance as stated in the policy is "Trust and respect are diminished when those in positions of authority abuse or appear to abuse their power."

Recommendation: In combination with other audit findings in this report and in light of the importance of the position of Assistant Provost, it is our opinion this violation represents a very serious offense and the punishment should reflect this. The University's sanctions

FINDINGS AND RECOMMENDATIONS (cont'd)

against improper relationships include a warning, a letter of reprimand, suspension (with or without pay), diminishment in rank, or discharge from employment. University management should consider the strongest disciplinary action available given the magnitude of the misconduct and send a clear message throughout the University that such conduct is not tolerated.

Response: In accordance with University policies and the results of the investigative audit, the Assistant Provost has been removed from all administrative responsibilities.

4. THE ASSISTANT PROVOST CHARGED PERSONAL EXPENSES TO A CREDIT CARD ISSUED BY THE UNIVERSITY.

We found personal items charged to the Assistant Provost's credit card issued by the University in violation of the University's policy on University-issued credit card use. The Assistant Provost said, "I charged everything on the credit card and that is why it was taken away." He stated many other University employees had used their University-issued credit cards for personal use. He said the former University Chancellor "laid down the law" regarding improper credit card use. The Assistant Provost said he was issued another credit card by the University and currently uses the card only for business purposes. A former University credit card administrator indicated a review of credit card usage was conducted at that time and a number of credit cards were revoked. It is our understanding that a credit card audit was initiated by a former internal auditor, but this audit was suspended by the previous University management. The current internal auditor was not aware of the reason for the suspension.

Recommendation: Controls should be reviewed to ensure employees use credit cards issued by the University for business use only. In addition, periodic audits of credit card usage and appropriate management actions for violations should be undertaken. We believe it would be prudent of the University to review the prior credit card audit.

Response: The University will review controls over university-issued credit cards and conduct periodic internal audits of credit card usage. It should be noted that the University is not liable for individual credit card charges.

5. GRADUATE ASSISTANT PAYMENTS WERE IMPROPERLY CHARGED TO FEDERAL GRANTS.

Our investigation determined that three of 20 graduate assistants whose payments were authorized by the Assistant Provost were paid \$16,100 in total and performed work unrelated to research grants, although their expense was charged to the grants. Two graduate assistants with contracts totaling \$11,000 worked in the Office of International Affairs performing

FINDINGS AND RECOMMENDATIONS (cont'd)

administrative duties. A third graduate assistant with a contract for \$5,100 spent a portion of his time handling administrative work for Board of Trustees meetings. The description of the work stated on the forms for graduate assistant employment was "Research" or "Research/administrative."

As the Principal Investigator for the federal research grants, the Assistant Provost has the responsibility to ensure the proper use of funds. The Assistant Provost claimed that the reason he provided graduate assistants to the Office of International Affairs "could have been because they were trying to get their program up and running." He said he "probably loaned out" graduate assistants to the Office of International Affairs to assist with clerical work. One of these graduate students verified she and another student performed some administrative work for the Office of International Affairs, but none of the work was related to research. The Director for the Office of Sponsored Research did not remember any research activities with the Office of International Studies. The supervisor for another student indicated the student performed work for the Board of Trustees, including duties such as sending out meeting minutes. Based on these findings, the graduate students' expenses should not have been charged to the federal research grants.

Recommendation: University should make the proper accounting adjustments to correct the improper charges to federal grants. The University should also implement administrative controls to ensure proper use of these funds. Potential controls could include updating the employment recommendation forms to require more specificity of the work to be done, requiring a written job description signed by the student, requiring a written evaluation of job performance signed by the supervisor and student, requiring timesheets to be filled out by the student and approved by the supervisor, and ensuring these documents are reviewed by the Contracts and Grants or Budget Office to help ensure fund objectives are met. We believe it would be prudent of the University to review all grants for proper accounting of graduate assistant payments.

Response: The University will review its current procedures and make the necessary adjustments to further reduce the possibility of fraud. Additionally, the University will review the improper charges and make the needed corrections.

6. HONORARIA PAYMENTS DID NOT HAVE PROPER APPROVALS AND LACKED WRITTEN JUSTIFICATION.

In addition to the \$14,377 in honoraria payments noted in the table on page 5, we found another \$14,415 in honoraria payments paid to individuals who advised the University on research matters. The Purchasing Director indicated these payments, typically in amounts of \$1,000, were considered as gifts that only covered expenses and did not reflect the usual rates the individuals could obtain. The Contracts and Grants Director indicated honoraria are

FINDINGS AND RECOMMENDATIONS (cont'd)

allowed under federal grants and are written into proposals for those grants. The Federal Grants Officer for the Overcoming Racial Health Disparities grant indicated it was permissible to charge honoraria to the grant as long as it was in the budget and associated with a task specified in the grant.

However, we found honoraria do not have adequate internal controls when compared to other service or consulting agreements. For example, the Assistant Provost's signature was the only one found on the honoraria authorization forms. In addition, there was no independent review of the credentials of the honoraria recipients. Finally, no documentation was required to indicate the service had occurred.

Recommendation: A University Vice Chancellor or above should review written credentials of prospective honoraria recipients and should approve all honoraria forms. A minimum of two signatures should be required on the honorarium authorization form. The Contract and Grants Office should require evidence of honoraria recipient attendance and should include such documentation in the file.

Proper accounting corrections should be made for improper honoraria payments charged to grants. We believe it would be prudent of the University to review all grants for proper accounting of honoraria payments.

Response: The University will undertake a thorough review of the honoraria process and make the necessary revisions in requirements for documentation, review, and approval to further reduce the possibility of fraud. Additionally, the University has placed a moratorium on honoraria payments until controls are strengthened. Corrections will be made for falsified honoraria payments.