

Minutes of the February 10, 2006 Meeting
of the Board of Governors' Audit Committee

The Audit Committee met in Conference Room C of the General Administration Building in Chapel Hill, North Carolina on Friday, February 10, 2006, at 8:00 a.m.

Members in attendance were Mr. F. Edward Broadwell, Jr., Mr. John W. Davis III, Ms. Hannah D. Gage, and Mr. William G. Smith. Necessarily absent were Mr. William L. Burns, Jr. and Dr. Irvin A. Roseman. Board of Governors member Phillip R. Dixon was also in attendance. Others attending the meeting were Chief of Staff Jeffrey R. Davies; Vice President Leslie Winner; Associate Vice Presidents George Burnette, James O. Smith, Joni Worthington, and Laura Young. In attendance from East Carolina University was Chancellor Steven C. Ballard, Provost James Smith, and Internal Auditor Stacie Tronto, as well as Mr. George Briggs, Director of The North Carolina Arboretum.

Chair Smith convened the meeting and welcomed everyone to the inaugural meeting of the Committee. He asked for a motion to approve the agenda.

On the motion of Mr. Davis, seconded by Ms. Gage, the agenda was approved.

Chair Smith called upon Mr. Burnette to review the recommendations approved by the Best Financial Practices Task Force. Questions and comments were made throughout the presentation.

The next item for consideration was the proposed Charter for the Committee. In November 2005, the Board adopted the recommendations of the Best Financial Practices Task Force. As part of those recommendations, the Committee was charged with developing and adopting its Charter.

It was recommended that the following Charter be approved and presented to the Board of Governors for final approval.

Audit Committee Charter of the University of North Carolina Board of Governors

I. *Background*

All constituent institutions of the University of North Carolina, including UNC General Administration, are required by State law to have their financial audit conducted by the North Carolina Office of the State Auditor. Historically, the Office of the State Auditor has not performed non-audit services, including those prohibited by the Sarbanes-Oxley Act. The Office of the State Auditor determines staff assignments for individual audits, including rotation of Audit Managers for each audit client.

II. Purpose

To assist the UNC Board of Governors in fulfilling its responsibilities related to: ensuring that each constituent institution has an effective and independent internal audit function; ensuring that each constituent institution has an appropriate focus on ethical standards; ensuring compliance with General Statute 116-30.1; and ensuring compliance with UNC Board of Governors mandated requirements related to University-Affiliated Entities.

III. Organization

The Audit Committee shall be a standing committee of the UNC Board of Governors. The Chairman of the Board of Governors will select members of the Committee. There shall be a minimum of six (6) members. Each Committee member must be independent of management and free of any relationship that would impair such independence. Members may not receive consulting, advisory, or other fees from any of the constituent institutions or UNC General Administration.

If practicable, at least one member of the Committee should be a financial expert. A financial expert is someone who has an understanding of generally accepted accounting principles and financial statements, preferably relative to higher education; experience in applying such principles; experience in preparing, auditing, analyzing, or evaluating financial information; experience with internal controls and procedures for financial reporting; or an understanding of the audit committee function. If feasible, the role of financial expert will be rotated on an annual basis.

IV. Meetings

The audit committee shall meet no fewer than four (4) times a year. The Committee will invite representatives of the constituent institutions, external and internal auditors, representatives of the Office of the State Auditor, legal counsel, and others to attend the meetings and to provide pertinent information as requested.

V. Duties and Responsibilities

The following shall be the principal duties and responsibilities of this Committee:

- Monitor the internal control, management staffing, and audit finding resolution requirements set out in General Statute 116.30.1.*
- Review the annual financial audits of the constituent institutions and other significant audit related communications from the State Auditor's Office or other external audit groups/*
- Request an annual overview from the State Auditor or a designated representative.*
- Review and approve an annual summary of the internal audit plans submitted by each constituent institution's and UNC General Administration's Director of Internal Audit.*
- Review an annual summary of the work performed by the Audit Committee of each institution's Boards of Trustees. This summary should incorporate a summary report of the audits, reviews, investigations or special assignments completed by each constituent institution's and UNC General Administration's internal audit department. This report*

should also contain identified material reportable conditions and how they were resolved.

- *Be available to meet during the year with the State Auditor or his staff for consultation purposes or to discuss the Auditor's judgments about the quality, not just the acceptability, of any accounting principles and underlying estimates in the preparation of a constituent institution's or UNC General Administration's financial statements.*
- *Serve as the Audit Committee for the UNC General Administration Internal Auditor.*
- *Review an annual report on University-Affiliated Entities.*
- *Develop and maintain a system-wide code of ethics.*
- *Participate, when necessary, in training sessions related to system-wide internal controls and internal/external audit issues.*
- *Request, as needed, that the State Auditor rotate the Audit Manager assigned to a constituent institution or UNC General Administration financial statement audit.*
- *Consult with the UNC General Administration Legal Counsel to review any legal matters that may have a significant impact on a constituent institution's or UNC General Administration's financial statements, overall financial performance, or compliance with applicable state, local or federal statutes.*

The Committee may modify or supplement these duties and responsibilities as needed.

The Committee shall have the authority to engage, in accordance with state rules and regulations, independent counsel or other advisors as necessary to carry out its duties. UNC General Administration shall provide appropriate funding, as determined by the Committee, for payment to advisors employed by the Committee.

The Committee, with the assistance of the appropriate Vice President, should periodically review and assess the adequacy of the Audit Committee Charter.

On the motion of Ms. Gage, seconded by Mr. Broadwell, the recommendation was approved.

After that, Mr. Burnette reviewed the following categories of reports issued by the North Carolina Office of the State Auditor.

Annual Financial Audits

These audits had two (2) primary objectives. The first objective was to express an opinion on the financial statements of the applicable campus. The second was to present any significant deficiencies in the internal controls over financial reporting or the university's ability to record, process, or summarize financial data and to present instances of noncompliance with laws, regulations, contracts, or grants.

Audit of Information Systems

The primary objective of these audits was to evaluate the information systems general controls on a particular campus. The scope of these audits included the information system controls over general security, access controls, program maintenance, systems software, systems development, physical security, operations procedures, and disaster recovery.

Investigative Audits

Typically, these audits resulted from calls placed to the State Auditor's Hotline alleging some type of abuse, misappropriation of funds, or misuse of state property.

Performance Audits

These were audits performed by the State Auditor's Office that reviewed programs and processes within State Government for the purposes of enhancing effectiveness and/or efficiency.

To date, 2005 financial audit reports by the North Carolina Office of the State Auditor had been released for five schools. The Committee discussed the following:

1. Appalachian State University: No Audit Findings
2. East Carolina University: One Audit Finding

INADEQUATE CONTROLS OVER FINANCIAL AID AWARDS

The University did not have adequate controls in place over the financial aid award process to assure proper segregation of duties or proper review and approval procedures. Employee information system access rights were inconsistent with the responsibilities of their jobs and would allow them to perform functions incompatible with their assigned duties. Employees could override system controls and allow students to qualify for additional federal aid by granting adequate academic progress appeals or by changing the expected family contribution calculation. They also had the ability to award discretionary aid without any type of review or approval.

A proper system of internal control ensured that the University developed adequate procedures that included segregation of duties to provide a proper review and approval process of changes in the financial aid database. Failure to maintain adequate internal controls over the awarding of financial aid could lead to an increased risk of errors, irregularities and abuse.

Recommendation: The University should strengthen internal controls within the Financial Aid Office to assure that no one individual controlled all the key aspects of a transaction or event. Also, the University should implement review and approval procedures over changes to academic progress appeals and changes to expected family contribution calculations.

University's Response: During the past year, the University had been reviewing and strengthening internal controls within the Financial Aid Office with regard to the awarding process. Since November 2004, discretionary aid overrides could be facilitated and entered by the Financial Aid Director and the Associate Financial Aid Director. Employee information system access rights and job responsibilities would be reviewed by the Office of Internal Audit to ensure there was an appropriate assignment of access rights based upon job duties in such a manner to provide an adequate segregation of duties. Internal control procedures would be developed and implemented to ensure that changes to academic progress appeals, changes to expected family contributions, and discretionary aid awards were properly reviewed and approved.

3. North Carolina School of the Arts: No Audit Findings
4. North Carolina State University: No Audit Findings
5. The University of North Carolina at Greensboro: No Audit Findings

On the motion of Chair Smith, seconded by Mr. Davis, the Committee went into closed session to plan, conduct, or hear reports concerning investigations of alleged criminal conduct. Chair Smith noted that Board of Governor's Chair Brad Wilson had left it to his discretion to determine if other Board members could attend closed session. It was decided that only members of the Audit Committee would be allowed in attendance during discussions of investigative audits.

CLOSED SESSION

The Committee returned to open session.

Chair Smith stated that because of the April meetings being abbreviated around President Bowles' inauguration, the next meeting of the Audit Committee would be in May.

There being no further business, the meeting was adjourned.

Mr. William G. Smith
Chair of the Audit Committee

Dr. Irvin A Roseman
Vice Chair of the Audit Committee

CLOSED SESSION

Chair Smith called upon Mr. Burnette and he explained the East Carolina University investigation and stated that the suspect had resigned from the university. He also informed the Committee of an Appalachian State University criminal investigation and informed that the suspect in that case had retired. This was followed by a short question and answer session.

On the motion of Ms. Gage, seconded by Mr. Davis, the Audit Committee returned to open session.