



STATE OF NORTH CAROLINA

NORTH CAROLINA BIOTECHNOLOGY CENTER

FINANCIAL RELATED AUDIT

OCTOBER 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

NORTH CAROLINA BIOTECHNOLOGY CENTER

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AUDITOR'S TRANSMITTAL

October 31, 2013

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Board of Directors, North Carolina Biotechnology Center
E. Norris Tolson, President and Chief Executive Officer

This report presents the results of our financial related audit at the North Carolina Biotechnology Center. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The results of our audit disclosed a deficiency in internal control and/or instance of noncompliance or other matters that is considered reportable under *Government Auditing Standards*. This item is described in the *Audit Findings and Responses* section of this report.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the North Carolina Biotechnology Center. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of not-for-profit entities that receive State appropriations.

The North Carolina Biotechnology Center (Center) was founded in 1984 as a private, non-profit organization. Its mission is to provide long-term economic and societal benefits to North Carolina through support of biotechnology research, business, education, and strategic policy. Biotechnology, according to Webster's Dictionary, is the manipulation (as through genetic engineering) of living organisms or their components to produce useful, usually commercial products. Biotechnology is used in areas such as making food more efficiently by increasing the yield per acre, making medicines and vaccines, and finding alternatives to fossil-based fuels to reduce pollution.

The General Assembly appropriated \$17,551,710 in State funds to the Center for fiscal year ended June 30, 2012. Approximately 92% of the Center's financing came from State appropriations during the year, with 8% coming from private gifts and grants or receipts for services. With the addition of other revenue sources, total expenditures for the Center totaled \$19,710,227. The expenditures were spent in the following categories: \$6,842,804 for grant expenditures, \$5,557,712 for program management expenditures, \$2,930,181 for general and administrative expenditures, and \$4,379,530 for other program and initiative expenditures. In addition, \$1,386,867 was paid out as loans to biotechnology companies.

AUDIT SCOPE AND OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Our audit scope covered the period July 1, 2011, through June 30, 2012. During our audit, we considered internal control related to the following accounts and control objectives:

Notes Receivable – The North Carolina Biotechnology Center (Center) loans state appropriations to biotechnology companies to facilitate company inception, research, and growth. On June 30, 2012, the Center reported a total of \$8,623,893 notes receivable which covers multiple years of loans. Of this total, the Center paid out \$1,386,867 of State funds on loan contracts during the audit period. Our objective was to determine if the Center had an adequate process in place to award and monitor the use of the loans. We examined internal control designed to ensure that the Center makes loans to appropriate parties with reasonable chance of repayment, that loans had been properly authorized, that signed contracts were obtained, that loans were monitored to prevent misuse of State funds, and that contract requirements were followed by the Center's subgrantees.

Allowance for Uncollectable Accrued Interest, Loan & Notes – This allowance account is the contra valuation account used to report the Center's expectation of loans and interest to be uncollectable. At June 30, 2012, the Center reported \$5,621,643 as its estimated uncollectable loan balance. This balance represents 61% of notes receivable. Our objective was to determine if the estimate was reasonable. We examined the Center's methodology to estimate the uncollectable loans and interest and compared the estimate to historical data of loan collections of the Center.

Grant Expenditures – The Center awards grants to organizations for collaboration, new ideas, education, research, and other activities that will make a technology licensable. During the audit period, the Center paid out \$6,842,804 in State appropriations to various types of grants. Our audit focused on two significant types of grants: Science and Technology grants and Centers of Innovation grants. Science and Technology grants fund biotechnology research and product invention. The Center spent \$3,202,136 (47%) on Science and Technology grants in the fiscal year ended June 30, 2012. Centers of Innovation grants fund expenditures related to accelerating growth in selected biotechnology industries and the commercialization of research in those fields. The Center spent \$2,043,046 (30%) on Centers of Innovation grants in the fiscal year ended June 30, 2012. Our objective was to determine if the Center had an adequate process in

AUDIT SCOPE AND OBJECTIVES (CONCLUDED)

place to distribute and/or monitor the grants. We examined internal control designed to ensure that the Center makes grants to appropriate parties, that grants originating in our period had proper contracts, that grants were monitored to prevent misuse of State funds, that contract requirements were followed by the Center's subgrantees, and that the Center complies with State laws and regulations.

METHODOLOGY

To accomplish our audit objective, we gained an understanding of internal control over matters described in the *Audit Scope and Objectives* section of this report and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objectives. Specifically, we interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances, as considered necessary in the circumstances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESULTS AND CONCLUSIONS

The results of our audit disclosed a deficiency in internal control and/or instance of noncompliance or other matters that is considered reportable under generally accepted government auditing standards. This deficiency was related to the *Grant Expenditures* account/objective. This item is described in the *Audit Findings and Responses* section of this report. Management's response is presented after the audit finding. We did not audit the response, and accordingly, we express no opinion on it.

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AUDIT FINDINGS AND RESPONSES

Government Auditing Standards require that we add explanatory comments to the report whenever an audit finding response is inconsistent or conflicts with the finding or recommendation. In accordance with this requirement and to ensure that the nature and seriousness of the findings are not minimized or misrepresented, we have provided comments to the Center's response.

ADDITIONAL DOCUMENTATION NEEDED FOR GRANT REIMBURSEMENT

The North Carolina Biotechnology Center (Center) reimbursed subrecipients for grant expenditures without always obtaining adequate documentation. Further, the Center's program review results are not communicated to the financial staff responsible for grant reimbursements. This lack of consistency could result in reimbursements made in error.

Documentation

During the audit period, the Center reimbursed subrecipients \$5,245,182 for Science and Technology and Centers of Innovation grants. Our test of a sample of 21 payments totaling \$662,233 out of 110 transactions revealed that four Science and Technology grant payments were made without adequate support to determine that the subrecipient had actually incurred the expenditures reported. These four reimbursement requests, totaling \$277,563, and representing 42% of the amount tested, did not include the support for reimbursement, such as copies of invoices, payroll registers, etc., as required of other similar subrecipients.

Grant Monitoring

The lack of formal communication between the financial staff and program experts may result in payments being made to subrecipients that should have otherwise been stopped or reduced. The Center's financial staff makes payments to reimburse subrecipients for qualified expenditures based on the individual terms of each grant. The Center's technical program experts perform desk reviews and on-site visits of subrecipients to determine that the grant objectives are achieved. However, we noted that these desk reviews and on-site visits, which document the subrecipients' progress toward meeting the agreed upon goals of the grant, are not communicated to the financial staff who process the payments. While no issues were noted in our sample, if problems were to be identified during the monitoring visits or desk reviews, the lack of formal communication may result in payments being made that should have otherwise been stopped or reduced.

Recommendation: The North Carolina Biotechnology Center should require adequate support with all reimbursement requests to ensure that they are valid and support the program objectives. In addition, the Center should communicate the grantees' progress to the financial staff to ensure that cost reimbursements are consistent with the accomplishment of the grant objective.

Auditee Response: We appreciate the State Auditor's professional and comprehensive review of our grant and loan programs. We pride ourselves in being good stewards of the State's dollars by carefully evaluating grant proposals and being conservative in our lending and

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

valuation, as noted here in this report. We agree with the audit finding that good documentation and communication are critical to ensuring that limited resources are spent as intended with the proposed outcomes. Our response to the finding is below:

Documentation

The four reimbursement requests, that gave rise to the finding, were all made to large institutions. The Biotech Center's grant agreement requires all subrecipients to keep receipts, vendor invoices, payroll registers and other documents that support their grants. We require subrecipients to make such documentation available to Biotech Center staff upon request. Each subrecipient signs a contract accepting that responsibility.

Larger institutions generally do not submit this documentation; however, they maintain it on file in their systems and send us a basic invoice. Others, often smaller institutions, choose to submit the documentation with their invoices.

Additionally, these larger institutions receive both Federal and State grant funds for which a Single Audit is required. The Single Audit is also called an A-133 audit, which is performed annually by an independent certified public accountant (CPA) and is a rigorous, organization-wide audit designed to provide assurance as to the entity's internal controls, and management and use of both Federal and State funds. If a subrecipient institution falls under the A-133 requirement, the Biotech Center obtains, reviews, and relies upon the Single Audit report as evidence that the institution has adequate controls in place over their grant administration process.

We acknowledge the responsibility to ensure that grant funds are spent according to the parameters of the grant award. Based on the Auditor's recommendations, we will randomly request and review, on a quarterly basis, test samples of documentation to support invoices from subrecipients that do not already provide such documentation.

Responsibility for requesting test samples as indicated above resides with the financial staff of the Biotech Center and we will begin this process in the third quarter of fiscal year 2014.

Grant Monitoring

While the technical program experts and the financial staff do communicate regularly regarding progress on assigned projects, we acknowledge that documentation supporting that communication could be enhanced. Our current communication methods will be enhanced to provide additional documentation in the financial files to improve accountability.

Progress reports - Subrecipients file periodic progress reports as required by the terms of their grant agreement put in place upon award. Program experts review these reports ("desk review") to ensure they are consistent with the original approved grant proposal. The findings of the desk review are currently communicated informally to financial staff if there are interim steps, with the final communication being a simple signature. We will enhance this process by instituting a new formal notification and check-off document from program experts to

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

financial staff that captures any interim steps (such as requests for additional information) and also provides more specificity for whether payments should be suspended or cancelled. The responsibility for communicating the results of these reviews will reside with the Biotech Center program experts and will begin during the 3rd quarter of fiscal year 2014.

Final reports – Final payments are not disbursed to grantees until final project reports are filed by the subrecipient, reviewed and approved by Biotech Center program experts, and communicated to financial staff. These reports contain a summary of the outcomes of the project as well as an accounting of the actual expenditures, and are reviewed for compliance with the Aims and Budget from the original approved grant proposal.

Site visits conducted by Biotech Center program experts – Biotech Center program experts conduct site visits with the principal research experts of the subrecipient for select grants throughout the year. These visits address the progress of subrecipient activities toward meeting the approved grant objectives. While these visits are not intended to review the subrecipient's financial administration of the grant, the Biotech Center will prepare a list of appropriate project budget-related questions for the program experts to pose to the subrecipients during the visit. Site visit reports are currently prepared but will be enhanced to include the results of the questionnaire as well as language which authorizes the continuation of payments by Biotech Center financial staff. The resulting site visit reports will then be provided to Biotech Center financial staff for review and follow-up if needed. The development of the budget related questionnaire is assigned to Biotech Center financial staff working with program staff for implementation in the 3rd quarter of fiscal year 2014.

Site visits conducted by Biotech Center financial staff – As a result of the auditor's finding, the Biotech Center will also require financial staff to perform a limited number of site visits each year to a subrecipient's grant administration office (e.g. a university's Office of Sponsored Research) for the purpose of document inspection and verification of expenses. A report of the visit will be prepared and placed in the grant file to substantiate the enhanced monitoring procedure. Responsibility for these site visits will reside with the Biotech Center's financial staff and may begin during the 3rd quarter of fiscal year 2014.

Quarterly Meetings – Finally, beginning in the third quarter of fiscal year 2014, technical program experts and financial staff of the Biotech Center will meet formally on a quarterly basis to discuss the status of active grants and address concerns, if any.

Auditor's Comment: In its response for the Documentation section of the finding, the auditee stated that receipts, vendor invoices, payroll registers and other documents that support the subrecipients' expenditures of the large institutions grants were not required to be submitted with the subrecipients' request for reimbursement but were to be made available to Biotech Center staff upon request. During our audit period the Biotech Center did not request additional documentation from the larger institutions. If these requests had been made and the documentation reviewed, this finding would not have been necessary. In its response, the auditee stated that site visits will now be conducted to review a sample of the documents. If sufficient monitoring is performed, this action will address our issue.

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ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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