

STATE OF NORTH CAROLINA

**THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
CHAPEL HILL, NORTH CAROLINA**

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
CHAPEL HILL, NORTH CAROLINA
STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2013

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THE UNIVERSITY OF NORTH CAROLINA

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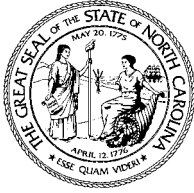
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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Board of Trustees
Dr. Carol L. Folt, Chancellor
The University of North Carolina at Chapel Hill

As part of our audit of the State of North Carolina's compliance with requirements applicable to its major federal programs, we have completed certain audit procedures at The University of North Carolina at Chapel Hill for the year ended June 30, 2013. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*. We conducted the audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Our audit objective was to render an opinion on the State of North Carolina's, and not the University's, administration of major federal programs. However, the report included herein is in relation to our audit scope at the University and not to the State of North Carolina as a whole. The State Auditor expresses an opinion on the State's compliance with requirements applicable to its major federal programs in the State's *Single Audit Report*.

The audit findings referenced in the report are also evaluated to determine their impact on the State's internal control and the State's compliance with rules, regulations, contracts, and grants. If determined necessary in accordance with *Government Auditing Standards* or the OMB Circular A-133, these findings are reported in the State's *Single Audit 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 options 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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**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND
MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Board of Trustees
and Management of The University of North Carolina at Chapel Hill

Report on Compliance

As part of our audit of the State of North Carolina's compliance with the types of requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major programs for the year ended June 30, 2013, we have performed audit procedures at The University of North Carolina at Chapel Hill. Our report on the State of North Carolina's compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with OMB Circular A-133 is included in the State's *Single Audit Report*. Our federal compliance audit scope at The University of North Carolina at Chapel Hill included the following:

- Research and Development Cluster

The audit results described below are in relation to our audit scope at the University and not to the State of North Carolina as a whole.

Management's Responsibility

Management is responsible for compliance with laws, regulations, contracts, and grants applicable to federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the State of North Carolina's major federal programs based on our audit of the types of compliance requirements referred to above, which we issue in the State's *Single Audit Report*. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133,

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Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion. However, our audit does not provide a legal determination of the University's compliance with those requirements.

Opinion on Each Major Federal Program

As stated above, our opinion on compliance for each of the State of North Carolina's major federal programs is included in the State's *Single Audit Report*.

Other Matters

The results of our audit procedures at The University of North Carolina at Chapel Hill disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in the Audit Findings and Responses section of this report.

Report on Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a

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type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we consider the deficiencies described in all of the findings in the Audit Findings and Responses section of this report to be material weaknesses in internal control over compliance.

Purpose of Report on Internal Control Over Compliance

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this communication is not suitable for any other purpose.

Management's Responses to Audit Findings

Management's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. The responses were not subjected to the auditing procedures applied in the audit of compliance or consideration of internal control over compliance, and accordingly, we express no opinion on them.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 14, 2014

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AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. INTERNAL CONTROLS OVER EQUIPMENT NEED IMPROVEMENT

The University did not maintain adequate equipment records, nor was equipment adequately safeguarded. Federal regulations (OMB Circular A-110, §215.34) state that equipment records should include the location and condition of the equipment (§215.34(f)(1)(vii)), and a control system should be in effect to ensure adequate safeguards to prevent loss, damage, or theft of equipment (§215.34(f)(4)).

We tested 60 pieces of equipment to ensure adequate records were maintained and assets were safeguarded. Of these items tested, three items were found to be in noncompliance.

- One item listed in the inventory at June 30, 2013 was returned to a vendor prior to June 30, 2013, but subsequent to the inventory date. The department did not notify asset management timely, as required by University policy.
- Two items listed in the inventory at June 30, 2013 could not be located. After our testing began, these items were determined to be missing. Proper documentation was not sent to asset management notifying them of the missing equipment until these items were requested as a part of audit procedures. This indicates that the University did not maintain adequate equipment records nor did they adequately safeguard these items.

Federal Award Information: This finding impacts federal research and development funding for July 1, 2012 through June 30, 2013.

Recommendation: The University should strengthen internal controls to adequately maintain equipment records and to safeguard equipment.

Response: The University acknowledges that for the three items noted in this finding, the University did not meet the requirements of OMB Circular A-110 215.34(f)(1)(vii) and (f)(4).

On an annual basis, each University department is responsible for conducting an inventory of capitalized equipment and reporting disparities to Asset Management. For the sample item that was returned to the vendor, the Department at issue has a large inventory that requires coordination of multiple laboratories and custodians. The Department began the inventory process in May 2013. In early June 2013, the laboratory where the sample item was located signed-off on its inventory, indicating the location of the sample item, and submitted the inventory to the Department's Facilities Manager, who coordinates the Department's inventory submission to Asset Management.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Subsequently, during the month of June 2013, the sample item was traded-in by the laboratory for a new item.

The Department submitted its consolidated inventory to Asset Management in August 2013. For the sample item, the Department should have updated Asset Management in a timelier manner as to trade-in of the item. Corrective action has already been taken regarding this item. The Capital Asset Manager has communicated with the respective laboratory and department regarding its obligation to track decaled items and to provide timely notification to Asset Management regarding any permanent change in the status of an item. In addition, the inventory records for the Department have been updated to reflect the status of this item.

For the two items that could not be located, we believe the primary reason for the inability to locate one item, a metallic tester, frequently used in coastal water research, is due to the remote location of where it was assigned and the utility of the item on many projects, resulting in it changing locations frequently. The metallic tester was acquired in January 1994 and had a book value in the Asset Management database of \$131 at fiscal year-end 2013. For the other item, a Pentium II computer purchased in 1999, we believe that turn-over in the Departmental representative responsible for managing physical assets contributed to Asset Management not being notified of the likely scrapping or transferring to University Surplus Property of the item. Given the age of this computer, we believe the value of the computer was insignificant.

Corrective action has already been taken regarding these two items. The Department at issue has filed the appropriate paperwork with Asset Management regarding the missing items and Asset Management has updated the equipment inventory appropriately. The Capital Asset Manager has also communicated directly with the Department regarding its obligation to track decaled items and to notify Asset Management regarding any permanent change in location or status of an item.

In addition to the corrective actions noted above, by April 30, 2014, the Capital Asset Manager will send a communication to campus reminding departments of the obligation to provide timely notification to Asset Management when there is a permanent change in location of a decaled equipment item or whenever an equipment item is lost, stolen, traded-in, scrapped, or transferred to another institution.

2. INTERNAL CONTROL DEFICIENCIES RELATED TO SUBRECIPIENT AUDIT FINDINGS

The University did not have a system in place to ensure that management decision letters were sent to subrecipients that had weaknesses identified in their audit report. Management decision letters are required to be issued by the University within six months after the receipt of the subrecipients' audit report which includes weaknesses. These letters should document the University's evaluation of the audit findings and corrective action plan submitted and a written decision as to what corrective action is

AUDIT FINDINGS AND RESPONSES (CONTINUED)

necessary. Also, there was not a system in place to ensure that the subrecipient took timely and corrective action on all audit findings.

We tested a sample of expenses paid to subrecipients, and for each subrecipient we reviewed the A-133 audit report obtained by the University to ensure that if weaknesses were noted, management decision letters were sent accordingly. During our testing, a management decision letter was sent for all audit reports that contained audit findings. However, lack of internal controls increases the risk that the monitoring would not be adequate, as well as the risk of noncompliance at the subrecipient level.

Federal regulations (OMB Circular A-133.400(d)(5)) require the University to issue a management decision letter on subrecipients' audit findings within six months after the receipt of the subrecipients' audit report. Further, the Circular requires that the University ensure that the subrecipient took timely and corrective action on all audit findings.

Federal Award Information: The finding impacts federal research and development funding for July 1, 2012 through June 30, 2013.

Recommendation: The University should strengthen internal controls over subrecipient monitoring.

Response: The University acknowledges that for the FY13 period it did not have a process in place to send management decision letters to subrecipients that have weaknesses identified in their A-133 audit reports, as required by A-133.400(d)(5). Effective with the request to subrecipients for FY12 audit reports, which occurred in Spring of FY13, the Office of Sponsored Research has implemented a process to issue management decision letters to subrecipients within six months after receipt of the subrecipients' audit report which includes weaknesses. The management decision letters notify each subrecipient that the review has been completed and identify any additional corrective action, as necessary.

3. FOR-PROFIT SUBRECIPIENT MONITORING NOT ADEQUATE

The University does not adequately monitor subawards issued to for-profit subrecipients. Federal regulations (OMB Circular A-133.210(e)) state that since OMB Circular A-133 does not apply to for-profit subrecipients, the pass-through entity (University) is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipient.

The University does not have an adequate system in place to ensure that for-profit subrecipients are monitored for compliance with the applicable requirements as stated in the subrecipient contract (OMB Circular A-133 compliance requirements). We tested twelve payments to for-profit subrecipients to determine if the University was adequately monitoring the expenses of the subrecipient to ensure compliance. There was no evidence

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

of monitoring for compliance of the for-profit subrecipients for eight of the twelve transactions we tested.

Federal Award Information: The finding impacts federal research and development funding for July 1, 2012 through June 30, 2013.

Recommendation: The University should strengthen their system to ensure adequate monitoring of for-profit subrecipients.

Response: The University acknowledges that its process for monitoring for-profit subrecipients could be enhanced to provide additional safeguards to ensure compliance of for-profit subrecipients.

The University's current process includes having the assigned Program Administrator in the Office of Sponsored Research review information provided by each potential subrecipient such as the type of entity (e.g., institution of higher education, for-profit), fiscal responsibility of the entity and audit status of the entity. This information is reviewed prior to the execution of a subagreement and can inform the University as to the monitoring needed for the subrecipient.

Throughout the subaward, subrecipient invoices are initially sent to the Principal Investigator, who has overall responsibility for the fiscal management of the project, to review and certify the appropriateness of the charges prior to being sent to the Office of Sponsored Research for payment. Upon receipt in the Office of Sponsored Research, invoices are reviewed by the pre audit team to ensure the time period of the invoice is within the budget period, costs correspond to the approved budget and costs do not exceed the authorized subaward amount. If the University has questions regarding a particular cost, the terms and conditions of the subaward provide the University with the right to request backup documentation from the subrecipient.

In addition to the invoice review process undertaken prior to payment, the post audit team in the Office of Sponsored Research performs a desk audit of randomly selected subrecipient invoices on a quarterly basis. This sampling of detailed costs can include for-profit subrecipient invoices.

To enhance the current process, the Office of Sponsored Research will expand its post award audit review to include a larger sample of for-profit invoices. This review will include obtaining and reviewing supporting documentation for the costs claimed on the invoice. In addition, a mini audit questionnaire will be implemented to assist with reviewing the for-profit subrecipient's internal control mechanisms (e.g., cash management, past audit findings, procurement systems, payroll management, property management, etc.), as well as to allow for further evaluation of the subrecipient's ability to comply with applicable requirements as stated in the subaward agreement.

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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For additional information contact:

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