

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR
BETH A. WOOD, CPA



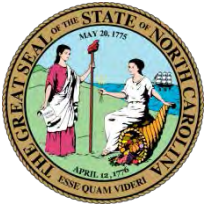
THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA
STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES
FOR THE YEAR ENDED JUNE 30, 2014



NC OSA
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor



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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, 2014. 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 was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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



**Beth A. Wood, CPA
State Auditor**

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Article V, Chapter 147 of the North Carolina General Statutes, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

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Office of the 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 for Each Major Federal Program

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, 2014, 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:

- Student Financial Assistance Cluster
- 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, *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 findings in the Findings, Recommendations, and Responses section of this report.

Report on Internal Control Over Compliance

Management of The University of North Carolina at Chapel Hill 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 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 findings 1 and 3 in the Findings, Recommendations, and Responses section of this report to be material weaknesses in internal control over compliance. Furthermore, we consider the deficiency described in finding 2 in the Findings, Recommendations, and Responses section of this report to be a significant deficiency in internal control over compliance.

The University of North Carolina at Chapel Hill's Responses to Audit Findings

The University's responses to the findings identified in our audit are included in the Findings, Recommendations, and Responses section of this report. The University's 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.

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.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 24, 2015



FINDINGS, RECOMMENDATIONS, AND RESPONSES

Management's responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them. However, *Government Auditing Standards* require that we add explanatory comments to the report whenever we disagree with an audit finding response or when a response could potentially cloud an issue, mislead the reader, or inappropriately minimize the importance of our findings. 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 University's response to finding number 2.

MATTERS RELATED TO FEDERAL COMPLIANCE OBJECTIVES

1. Satisfactory Academic Progress Policy Did Not Meet Federal Requirements

The University's undergraduate Satisfactory Academic Progress (SAP) policy does not meet the minimum elements required by Federal regulations. As a result, ineligible students could continue receiving assistance, potentially hindering other eligible students from receiving aid. For the fiscal year that ended June 30, 2014, approximately 12,813 students received \$194,741,088 in Title IV federal student financial aid.

SAP policies establish criteria to ensure that students continuing to receive assistance have a likelihood of success, and to ensure limited funds are used prudently. Federal regulations (34 CFR 668.16(e)) state that institutions must establish, publish, and apply reasonable standards for measuring whether eligible students maintain satisfactory academic progress. The regulations (34 CFR 668.34) further define the specific required elements for an institution's policy to be reasonable.

The following elements were omitted from the undergraduate policy:

- The University's undergraduate SAP policy does not specify the pace at which a student must progress through his/her educational program. Although the University's undergraduate policy requires a completion of a set number of hours at the end of each semester, the policy does not appropriately take into account all hours attempted by the student to determine the completion rate, as required.
- The University's undergraduate SAP policy does not describe how a student's GPA is affected by course incompletes, withdrawals, repetitions, or transfers of credit from other institutions.

The University's undergraduate SAP policy does not provide for notifications to students of the results of an evaluation that impacts the student's eligibility for Title IV and HEA programs.

Federal Award Information

Award Year July 1, 2013 – June 30, 2014. CFDA 84.007 Federal Supplemental Educational Opportunity Grants (FSEOG); CFDA 84.033 Federal Work Study Program (FWS); CFDA 84.038 Federal Perkins Loans (FPL); CFDA 84.063 Federal Pell Grant Program (Pell); CFDA 84.268 Federal Direct Student Loans (Direct Loan)

Recommendation

The University should revise its Satisfactory Academic Progress (SAP) policy to include all required elements as defined by the federal regulations.

Agency Response

Throughout its history, the University has maintained a single policy to define academic progress for undergraduate students regardless of their receipt of financial aid. The Office of Scholarships and Student Aid recently became aware of limitations within this longstanding academic progress policy and its corresponding procedures, and took action to correct them in early spring 2014. The state audit encompassed the 2013-14 academic year. During the audit entrance interview in June 2014, the University affirmatively and voluntarily disclosed to the Office of the State Auditor that the University had concerns about its prior policy and procedures and that it was in the process of amending its policy and procedures to address the deficiencies that had been identified. The University has implemented a new satisfactory academic progress policy and procedure for purposes of the Title IV federal student financial aid programs, effective with the 2014-15 academic year. The new policy and procedure addresses the prior shortcomings. Furthermore, the new policy and procedure is based on guidance in the U.S. Department of Education's Federal Student Aid Handbook, is now administered by the Office of Scholarships and Student Aid, and is currently in effect for all recipients of need-based financial aid.

Please refer to the new policy included on our website: <http://studentaid.unc.edu/eligibility-for-aid/sap/>.

2. Lack of Controls Over Required Direct Loan Reconciliations

The University does not have a system in place to ensure that the amount of Federal Direct Loans to students reported to the Department of Education agrees to actual loan disbursements in the accounting records. As a result, federal records could be inaccurate.

Federal regulations (34 CFR 685) require the University to reconcile Student Account Statement (SAS) data file (received from the Department of Education) to the University's financial records each month. During our testing, actual noncompliance was not identified. However, lack of internal controls increases the risk that the University would not comply with the federal regulations.

Federal Award Information

Award Year July 1, 2013 – June 30, 2014. CFDA 84.268 Federal Direct Student Loans (Direct Loan)

Recommendation

The University should implement controls to ensure that required reconciliations are completed timely and accurately.

Auditor's Response

In this finding, the Office of the State Auditor is reporting that there was not a system in place to ensure the reconciliations were performed as required by federal regulations. The federal compliance requirement states that, each month, the University must reconcile the Student Account Statement (SAS) data file (received from the Department of Education) to the financial records and have a control in place to ensure the reconciliation is performed and is accurate. During our audit, we did not see any evidence of a procedure to alert the University if the reconciliation was not performed or performed inaccurately. The University's response, while very comprehensive of the reconciliation process, does not demonstrate evidence of a control.

Agency Response

We acknowledge that there is no "signature" process by which a senior administrator reviews the efforts of other staff members. But, we do engage in a monthly aggregate reporting of totals that serves to inform three senior staff members of loan totals and reconciliation processes. We believe this to be a sufficient control and to surpass what is required by the applicable federal regulations. We also believe this monthly collection of data encompasses a process very similar to, and much more powerful than, a signature alone.

The University does have controls in place and does reconcile the Federal Direct Loan program on a monthly basis.

This reconciliation examines:

- (1) Actual disbursements to students in the accounting records of the University,
- (2) Actual disbursements to students as recorded on their student account, and
- (3) Actual disbursements to students as recorded by the federal government

We reconcile each student's disbursement totals for each award year as recorded in the student account. These amounts are compared and aligned to the student's disbursement records held by the federal government. The records are reconciled by comparing lists of the balances obtained from the University's PeopleSoft system and from the U.S. Department of Education Common Origination & Disbursement (COD) system. We also compare the cumulative total of the disbursements for the award year from the student accounts and the COD system to the cumulative total recorded for the award year in the accounting records of the University. Each award year has a distinct Project ID in the general ledger where all disbursements are recorded; therefore, disbursements are easily reconciled and kept in alignment. The University has successfully reconciled and closed each year of its participation in the Direct Loan program with a zero cash balance and has done so by the required deadline.

We regret that we may not have fully described our reconciliation efforts to the audit team while they were on campus. The office does compare the loan disbursement records, including a tie to the accounting system, for all students receiving a loan. Those records are compared and discrepancies are identified and resolved. The accounting records are linked directly to the disbursement record in the PeopleSoft system.

A record cannot exist in the accounting system for a student without first existing in the PeopleSoft system. We believe controls are adequate as they currently exist.

In addition to the above efforts, on a monthly basis, the deputy director compiles aggregate information regarding disbursed Federal Direct Loans. In a monthly spreadsheet, the deputy director lists the disbursed loan totals from the PeopleSoft system. Also, the deputy director lists the disbursed totals as reported to the COD system. These totals are then sent in an attached spreadsheet to the senior associate director of financial aid and the associate provost/director of financial aid. The director reviews, monthly, all loan reconciliation records submitted to General Administration as part of the ongoing Business Compliance Program (formerly FIT).

We believe the current monthly review by the director to be a sufficient control. However, a monthly signature process will be implemented effective with the 2015-16 academic year.

3. Lack of Salary and Wage Certifications Increases Risk of Inappropriate Charges to Federal Grants

The University did not timely approve all of the required Effort Certifications¹ necessary to ensure that all salaries and wages charged to federal grants were for services rendered under those grants. The University had 300,396 transactions for salaries and wages totaling \$195,841,274 that were paid from federal funds in fiscal year 2014.

Out of a sample of 60 randomly selected salary and wage transactions billed to federal grants, 11 transactions (18%) did not meet federal requirements²:

In 6 out of 60 (10%) transactions tested, the payee completed their Effort Certification but it was not certified (approved) by appropriate personnel within the appropriate time frame established by the University.

In 5 out of 60 (8%) transactions tested, the payee did not complete the Effort Certification at all.

Because the University did not timely approve and obtain all of the required certifications, there was an increased risk salary and wage charges could be inappropriately billed to federal grants.

The University did not timely approve and obtain all of the required certifications due to turnover and lack of training at the department level, where the responsibility for the certifications was not reassigned. Additionally, the importance of these certifications was not emphasized at the department level.

Federal regulations state that the distribution of salaries and wages for individuals paid in connection with federal research and development grants must be accurately

¹ Effort Certifications are the documentation that certifies to the federal granting agencies that the effort required as a condition of the award has actually been completed. Effort reporting is required by OMB Circular A-21 which requires certification of effort spent by all employees whose salaries are charged directly to federal and federal flow-through funds

² Per Appendix A of 2 CFR Part 220 – J.10.b.(2).c.(2)(c)

confirmed (i.e. documented) or approved after the work was performed. To comply with federal requirements, the University established a policy to confirm salaries and wages for non-professorial and non-professional staff paid from federal grants on a quarterly basis and all other staff on a semi-annual basis. University policy also states that the salary and wage certifications must be approved within 30 days after the certification period ends.

Federal Award Information

This finding impacts federal research and development funding for July 1, 2013 through June 30, 2014.

Recommendation

The University should strengthen controls over effort certifications to ensure they are completed and approved in a timely manner.

Agency Response

In April of 2015, we will begin working with Huron Consulting Services, LLC (Huron) to initiate an upgrade to our effort reporting software effecting a transition to the most current version 5.1. Through this upgrade, we will gain critical enhancements necessary for improving timeliness of our reporting as well as making the process much more efficient and user friendly for our Principal Investigators (PIs) and research community.

Through the course of this upgrade, Huron will provide support to update our related training materials to reflect the use of the new functionality gained. Once the training materials have been modified and updated, we will implement a communication and training plan that will include mandatory training for all Primary Effort Coordinators as well as anyone assigned as a backup Primary Effort Coordinator. In addition, we will be posting an on-line training module and prior to a new hire being assigned the role of Primary Effort Coordinator, they will be required to complete the on-line training. We will also offer training to all Principal Investigators and other certifiers emphasizing the importance of reviewing and certifying their effort reports as well as the procedure for completion in the upgraded system. In keeping with the trainings for the Primary Effort Coordinators, we also create and post an on-line training module that is specific to the role of the Principal Investigators and others required to certify their effort.

Lastly, we will also be updating our Effort Reporting Policy and Procedures to reflect the changes brought about by the system upgrade as well as the implementation of the Uniform Guidance. The revised policy and procedures will include clear guidance on a reminder and escalation procedure that will be initiated, as necessary, following the certification due date for those reports that have not been certified. The escalation procedure will involve communication from the Associate Vice Chancellor for Research/Director, Sponsored Research to the Deans of Schools, as warranted, to ensure that certifications are completed.

In instances where a report remains uncertified after the reminder/escalation procedure, the resulting action will be for the Office of Sponsored Research (OSR) to place the respective sponsored projects on hold and transfer all salary and associated fringe benefit charges from the sponsored projects (included on the remaining unprocessed

effort reports) to the department's non-sponsored account. The revision will additionally advise that if the costs are moved they may not be transferred back to the sponsored projects at a later date without the approval of the Associate Vice Chancellor for Research/Director, OSR.

Anticipated Completion Date: October 1, 2015.

ORDERING INFORMATION

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This audit was conducted in 1,359 hours at an approximate cost of \$127,746.