

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, 2016



NC OSA
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, 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, 2016. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). 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 major federal programs 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 finding in this report is also evaluated to determine its 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*, this finding is 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 black ink that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
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 THE UNIFORM GUIDANCE**

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 Compliance Supplement* that could have a direct and material effect on each of its major programs for the year ended June 30, 2016, 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 Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance) 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 federal statutes, regulation, and the terms and conditions of its federal awards applicable to its 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 disclosed instances of noncompliance that are required to be reported in accordance with the Uniform Guidance and which are described in the Findings, Recommendations, 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 the Uniform Guidance, 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 deficiency described in our finding in the Findings, Recommendations, and Responses section of this report to be a material weakness in internal control over compliance.

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

The University's response to the finding identified in our audit is included in the Findings, Recommendations, and Responses section of this report. The University's response was not subjected to the auditing procedures applied in the audit of compliance, and accordingly, we express no opinion on the response.

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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 16, 2017



FINDINGS, RECOMMENDATIONS, AND RESPONSES

Matters Related to Federal Compliance Audit Objectives

The following audit finding was identified during the current audit and describes conditions that represent a deficiency in internal control or noncompliance with laws, regulations, contracts, grant agreements, or other matters.

FAILURE TO COMPLETE REQUIRED FEDERAL AWARD CLOSEOUTS

The University did not complete closeout reconciliations of cash receipts and expenditures¹ for federally sponsored research and development (R&D) awards. During fiscal years 2014-2016, the University expended approximately \$1.8 billion on federally sponsored R&D awards.

Auditors reviewed queries of University information system award data and other award documentation. Auditors determined that 3,063 (63%) of 4,839 awards from the 2014-2016 fiscal years were required to be closed out but remained open as of June 30, 2016.

The financial impact of the incomplete closeout reconciliations is unknown. University management said that the awards have not been reconciled by Office of Sponsored Research (OSR) personnel to determine if any amounts should be refunded to or recovered from the federal government. Also, University management was unable to provide auditors with a reliable dollar amount of expenditures for the awards that were not closed out; therefore, the financial impact could not be determined.

Failure to perform closeout reconciliations for federally sponsored R&D awards increases the likelihood that the University will not identify overbilled amounts², leading to additional interest charges or penalties. In addition, the University may be unable to recover underbilled amounts², causing it to use University funds that would otherwise be available for other purposes.

According to the University, inadequate staffing levels prevented completion of the closeout reconciliations. University management said the OSR was staffed at 64% of budgeted positions in fiscal year 2016 with comparable staffing levels in fiscal years 2014 and 2015. OSR management elected not to allocate additional staff to perform closeout reconciliations due to ongoing issues associated with the new accounting system implementation which began in October 2014.

Federal regulations³ require the University to complete specific closeout actions for federal awards that have ended. The University must promptly refund any excess amounts that the University is not authorized to retain. Unreturned amounts constitute a debt to the federal government and can incur interest charges.

¹ The process by which the University determines that all applicable administrative actions and all required work of the Federal award have been completed and takes action as described in 2 CFR 200.343: Closeout.

² If the University billed the award sponsor for more than the actual amount of expenditures, the University would owe a refund to the sponsor for the overbilled amount. If the University did not bill the award sponsor for all eligible expenditures, it could seek reimbursement for the underbilled amount.

³ 2 CFR 200.345

Federal Award Information: This finding impacts research and development funding from July 1, 2013, through June 30, 2016.

Recommendation: The University's management should ensure that adequate staff are allocated to complete federally sponsored R&D award closeouts.

University Response

See pages 6-7 for The University of North Carolina at Chapel Hill's response.



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

CAROL L. FOLT
Chancellor

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March 1, 2017

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
20601 Mail Service Center
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Dear Auditor Wood:

Thank you for the opportunity to review the Office of the State Auditor's (OSA) draft Audit Findings and Recommendations from the federal compliance portion of the University's annual audit for the year ending June 30, 2016.

We take our responsibilities as a recipient of federal research funds seriously and appreciate the opportunity to respond to the audit finding and provide the steps we are currently taking place to address the matter.

The University acknowledges its challenges with respect to the timely closing out of federal awards.

As previously discussed with the audit team, issues developed during the implementation of the University's new accounting system, which rolled out in the first quarter of FY15. In addition, due to rapid growth in the University's research portfolio, the Office of Sponsored Research (OSR), which is principally responsible for the award closeout and reconciliation processes, faced staffing challenges. These issues concerning conversion and staffing contributed to the audit finding. At this time, the University estimates that the financial impact of the incomplete closeout reconciliations is not material in relation to the University's research portfolio during the applicable period.

Responsive to the Audit Findings and Recommendations, the University has taken the following corrective actions:

FINDINGS, RECOMMENDATIONS, AND RESPONSES

- Engaged the expertise of an external consulting firm focused on resolving the challenges created by the rapid growth in the University's research portfolio, the transition to a new accounting system and staffing levels in the OSR.
- Conducted a formal staffing assessment of the OSR and established an additional 37 FTEs to accommodate the University's current research portfolio and to ensure proper resourcing of OSR functions, including the closeout process.
- Created and staffed a team dedicated to final closeout and reconciliation processes, and that team is actively working through the population of awards requiring final closeout and reconciliation.

With additional dedicated resources engaged, we anticipate that by the conclusion of FY17, the University will have closed out and reconciled all federal awards ending in that fiscal year. The University's Office of the Vice Chancellor for Research has responsibility for this timeline and the corrective actions discussed above. For awards ending prior to FY17, we are engaged in ongoing conversations with the government to remediate closeout and reconciliation issues.

As noted above, UNC-Chapel Hill takes its obligations to the state and federal government very seriously. We value your service to the State of North Carolina and appreciate this opportunity to respond.

Sincerely,



Carol L. Folt
Chancellor

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