

STATE OF NORTH CAROLINA

SPECIAL REVIEW

NORTH CAROLINA SCHOOL OF THE ARTS

**NORTH CAROLINA SCHOOL OF THE ARTS
FOUNDATION, INC.**

WINSTON-SALEM, NORTH CAROLINA

SEPTEMBER 2004

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

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Ralph Campbell, Jr.
State Auditor

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LETTER OF TRANSMITTAL

October 5, 2004

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
President Molly Corbett Broad, University of North Carolina
Mr. Stephen P. Karr, Chairman, North Carolina School of the Arts Board of Trustees
Mr. Jeff Whittington, President, North Carolina School of the Arts Foundation Inc.,
Board of Directors

Ladies and Gentlemen:

Pursuant to General Statute §147-64.6(c)(16), we have completed our special review into allegations concerning the North Carolina School of the Arts. The results of our review, along with recommendations for corrective actions, are contained in this report.

General Statute §147-64.6(c)(12) requires the State Auditor to provide the Governor, the Attorney General, and other appropriate officials with written notice of apparent instances of violations of penal statutes or apparent instances of malfeasance, misfeasance, or nonfeasance by an officer or employee. In accordance with that mandate, and our standard operating practice, we are providing copies of this report to the Governor, the Attorney General and other appropriate officials.

Respectfully submitted,

A handwritten signature in cursive script that reads "Ralph Campbell, Jr.".

Ralph Campbell, Jr., CFE
State Auditor

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EXECUTIVE SUMMARY

During the State Auditor's annual financial audit of the North Carolina School of the Arts, the auditors discovered that one employee in the personnel department had been paid \$69,112.34 for overtime earned during a 29-month period, and that several employees had been given one-time special payments from 2001 to 2003.

The overtime payments appeared excessive, since the personnel department employee had earned an average annual salary of \$49,412 during the time involved. In addition, the overtime and the special payments to other employees appeared to have little documentation to justify the expenditures.

The financial auditors asked the Investigative Audit Division of the Office of the State Auditor to investigate the overtime and special payment issues.

In the course of their investigation, auditors found that the personnel department employee had been promoted in an apparent violation of State and University of North Carolina policies, and the School of the Arts administrators had ignored letters questioning the promotion by both the State and the University of North Carolina General Administration.

They also discovered that the personnel department employee had approved a one-time special payment and overtime payments for her sister. Other employees, including the personnel department employee and some senior administrators, also had been given one-time payments for work that appeared to be directly related to their normal duties. In

EXECUTIVE SUMMARY (CONTINUED)

addition, a personnel assistant had received more than \$5,000 because of incorrect overtime calculations.

Investigators checking the School of the Arts payroll also found that some employees appeared to be abusing a loan program financed by a donation that was intended to help faculty and staff with financial emergencies and moving expenses.

Research into the North Carolina School of the Arts Foundation, Inc., found that State and Foundation money had been improperly diverted to discretionary accounts controlled by senior administrators at the school, and that the Foundation board of directors was unaware of the discretionary accounts.

In addition, auditors found that the Vice Chancellor for Finance and Administration¹ had received more than \$90,000 over 13 years in consulting and expense payments that violated University of North Carolina policies. The Foundation Controller admitted that she misled the financial auditors each year when asked whether any outside payments were being made to senior administrators of the school.

The Vice Chancellor for Finance and Administration, on two separate occasions, transferred the ownership of land held by the Foundation for the School of the Arts without authorization to a nonprofit corporation he controlled and misapplied over \$285,000 from the sale of the land.

¹The Vice Chancellor for Finance and Administration resigned from his position with the North Carolina School of the Arts on July 13, 2004.

EXECUTIVE SUMMARY (CONTINUED)

The Vice Chancellor and the Dean of the School of Filmmaking also received payments from a third nonprofit corporation, the NCSA Unity Development Corporation, in violation of University of North Carolina regulations.

Auditors concluded that the University of North Carolina Board of Governors should consider whether to allow the School of the Arts to continue exercising budget flexibility given the scope of the audit findings. In addition, the University of North Carolina and Board of Governors should require all universities to research, identify and report on all foundations and other nonprofits associated with the universities.

Findings and Recommendations

1. **THE NORTH CAROLINA SCHOOL OF THE ARTS TWICE RECLASSIFIED A POSITION IN THE PERSONNEL DEPARTMENT WITHOUT THE APPROPRIATE APPROVAL OF THE UNIVERSITY OF NORTH CAROLINA OFFICE OF THE PRESIDENT AND THE OFFICE OF STATE PERSONNEL.**
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EXECUTIVE SUMMARY (CONCLUDED)

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INTRODUCTION

During the State Auditor's annual financial audit of the North Carolina School of the Arts (NCSA), the auditors noted several issues concerning overtime and one-time special payments made to employees from 2001 through 2003. It appeared two employees were overpaid due to incorrect calculations of overtime. In addition, one of these employees was paid a total of \$69,112.34 for overtime during a 29-month period, which seemed excessive, since her base salary averaged approximately \$49,412 a year. Additionally, for the fiscal years ended June 30, 2002, and June 30, 2003, the school paid 20 employees special one-time payments ranging from \$1,500 to \$5,000 and totaling \$53,325.82. These one-time payments appeared inappropriate for a variety of reasons.

The financial auditors obtained preliminary documentation surrounding these payments and referred the issues to the State Auditor's Investigative Audit Section for further examination. We used the following procedures to conduct a special review of these issues, as well as subsequent issues that surfaced:

- Examination of selected NCSA financial records, employees' timesheets and payment-related documents.
- Examination of selected financial records belonging to the North Carolina School of the Arts Foundation, Inc., the North Carolina School of the Arts Program Support Corporation, the NCSA Unity Development Corporation and the NCSA Housing Corporation.
- Interviews with NCSA employees.
- Interviews with individuals external to NCSA, including University of North Carolina employees.

INTRODUCTION (CONCLUDED)

This report presents the results of our special review. The review was conducted pursuant to General Statute §147-64.6(c)(16) rather than a financial audit. The North Carolina School of the Arts is a constituent institution of the 16-campus University of North Carolina system which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

ORGANIZATION OVERVIEW

The North Carolina School of the Arts

The North Carolina School of the Arts (NCSA) was established in 1965 and became a part of the University of North Carolina system in 1972. The mission of NCSA is to train students for professional careers in the arts. NCSA is made up of five professional schools: dance, design and production, drama, filmmaking and music. NCSA is accredited by the Southern Association of Colleges and Schools to award the high school diploma, the college arts diploma, the professional arts certificate and bachelor's and master's degrees.

NCSA's Chancellor is responsible for academic, artistic, financial, development, public relations, employment and student affairs actions. The NCSA Board of Trustees, NCSA Foundation Board of Directors and NCSA Board of Visitors advise the Chancellor regarding campus initiatives. The Chancellor also consults his administrative staff made up of the vice chancellors, deans, cabinet, faculty and staff councils. The Chancellor is responsible for recommending actions and reporting to the President of the University of North Carolina and University of North Carolina Board of Governors.

In the fall of 2003, NCSA enrolled 1,074 students and employed approximately 400 full-time employees, including faculty. For the fiscal year ended June 30, 2003, the budgeted state appropriation to the school was \$15,917,599.49.

ORGANIZATION OVERVIEW (CONTINUED)

The North Carolina School of the Arts Foundation, Inc.

The North Carolina School of the Arts Foundation was established in 1964. The Foundation is the recipient of gifts, endowments and grants made to the NCSA.

Currently the Foundation manages an endowment of more than \$15 million which is intended to enhance student life through scholarships, guest artists and other school programs. The Foundation's by-laws set the number of its board of directors at no less than three (3) and no more than thirty (30). The mission of the Foundation's board of directors is to advance the programs and priorities set by NCSA Administration while maintaining the Foundation's financial integrity.

The Foundation's board serves in fiduciary, advisory, and ambassadorship roles to NCSA. Fiduciary duties include overseeing the receipt, management and disbursement of NCSA's private funds, establishing NCSA's investment objectives for endowments, approving annual operating budgets and helping with fundraising activities. The Foundation board also advises NCSA's administration in development, marketing and public relations. The Foundation board also promotes awareness of NCSA's mission, objectives, activities and financial goals to the general public.

North Carolina School of the Arts Program Support Corporation

The North Carolina School of the Arts Program Support Corporation was incorporated in May 1997. The purpose of the Program Support Corporation is to operate as a nonprofit

ORGANIZATION OVERVIEW (CONTINUED)

organization “...for the benefit of, to perform the functions of, or to carry out the purposes of the North Carolina School of the Arts...”² As of July 1, 2004, the board governing the Program Support Corporation consisted of the NCSA Chancellor, the NCSA Vice Chancellor for Finance and Administration, and the NCSA Provost/Vice Chancellor for Arts and Academic Programs.

The Program Support Corporation did not maintain minutes of meetings. The Program Support Corporation engaged independent auditors to conduct audits for the fiscal years ended June 30, 1998 and 1999, but no audits have been performed since that date. From July 1, 2002 to June 1, 2004, \$443,529.68 was deposited in the Program Support Corporation bank accounts and \$255,274.15 was disbursed from its bank accounts.

It appears the primary source of funding originated from the disposition of \$285,945 of Foundation assets (see findings 9 and 10), borrowing \$150,000 from two commercial banks, and \$16,728 from an investment in a hotel in Winston-Salem, NC. The funds were used for expenditures such as a down payment for a new residence for the Chancellor, principal and interest payments on bank loans, a loan to the NCSA Housing Corporation, a consulting fee for the River Run Film Festival, travel expenses, and a piano lab for the NCSA School of Music.

²North Carolina School of the Arts Program Support Corporation Articles of Incorporation

ORGANIZATION OVERVIEW (CONTINUED)

The NCSA Vice Chancellor for Finance and Administration controlled the checkbook and authorized disbursements. His Executive Assistant prepared the checks for his signature.

NCSA Unity Development Corporation

The NCSA Unity Development Corporation was incorporated in January 2003. The purpose of the NCSA Unity Development Corporation is to operate as a nonprofit organization “...for the benefit of, to perform the functions of, or to carry out the purposes of the North Carolina School of Arts....”³ The original board members consisted of the Chancellor, the Vice Chancellor for Finance and Administration, and the Provost/Vice Chancellor for Arts and Academic Programs. Subsequently, five additional board members were appointed and the Vice Chancellor for Finance and Administration tendered his resignation as a voting member to the board because he was being compensated for his services.

In April 2003, the NCSA Unity Development Corporation contracted with the Vice Chancellor for Finance and Administration to

...oversee the entire operation of Unity utilizing contractual methodology to bring about the construction of office space for Krispy Kreme headquarters; design, construction and management of Unity Place Cineplex and the adjoining IMAX theaters, and to purchase and establish land leases needed to fulfill our obligations.

³NCSA Unity Development Corporation Articles of Incorporation

ORGANIZATION OVERVIEW (CONTINUED)

In November 2003, the NCSA Unity Development Corporation contracted with the NCSA Dean of the School of Filmmaking to

...be charged with conceiving of and supervising the execution of the design, construction, planning and operation of the multiplex theater (Unity Place Cineplex) and IMAX Theater intended for Unity Place...

No independent audits have been performed on NCSA Unity Development Corporation since its inception. Since January 1, 2003, the NCSA Unity Development Corporation has deposited \$184,061.67 in its checking account and disbursed \$132,863.75 from its checking account.

It appears the primary source of funding originated from a \$200,000 commercial line-of-credit with a local bank. The funds were used to pay expenses such as consulting fees for the Vice Chancellor for Finance and Administration and the Dean of the School of Filmmaking, an earnest money deposit with a real estate company, travel expenses, and principal and interest payments on the line-of-credit.

According to the Vice Chancellor's Executive Assistant, the Vice Chancellor for Finance and Administration maintained the checkbook and she prepared checks for his signature. The Vice Chancellor for Finance and Administration and his Executive Assistant handled most of the administrative duties such as checking the post office box and paying bills.

When we asked about the location of the financial records, we were originally told the records were maintained at an office location in Winston-Salem. Later we determined the

ORGANIZATION OVERVIEW (CONTINUED)

Vice Chancellor for Finance and Administration was referring to an office he had setup in the bedroom of the model apartment of Center Stage Apartments (the apartments are owned by the NCSA Housing Corporation).

NCSA Housing Corporation

The NCSA Housing Corporation was incorporated in February 2001. The purpose of the NCSA Housing Corporation is to operate as a nonprofit organization “...for the benefit of, to perform the functions of, or to carry out the purposes of the North Carolina School of the Arts...”⁴ The board consists of the Chancellor, the Vice Chancellor for Finance and Administration, and the former Vice Chancellor for Development.

No independent audits have been performed of the NCSA Housing Corporation since its inception. From June 15, 2001, to May 28, 2004, the NCSA Housing Corporation deposited \$3,663,878.58 in its bank accounts and disbursed \$3,539,010.06 from its bank accounts.

It appears the primary source of funding originated from \$6,400,000 in construction and bridge loans and subsequent lease payments received from students. According to the Vice Chancellor for Finance and Administration, bond financing is expected to be finalized in the fall of 2004 to pay off the outstanding loans. The funds were primarily

⁴NCSA Housing Corporation Articles of Incorporation

ORGANIZATION OVERVIEW (CONCLUDED)

used to pay the cost of building a 78-unit apartment complex known as “Center Stage Apartments”. The Apartments are leased to students of the North Carolina School of the Arts and Winston-Salem State University.

According to the Vice Chancellor’s Executive Assistant, the Vice Chancellor maintained the checkbook and she prepared checks for his signature.

Subsequent Events

The Vice Chancellor for Finance and Administration also served as Assistant Secretary and Assistant Treasurer for the North Carolina School of the Arts Foundation, Inc. He resigned from his position with the Foundation on June 21, 2004. On July 13, 2004, he resigned from his position with the North Carolina School of the Arts.

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FINDINGS AND RECOMMENDATIONS

1. THE NORTH CAROLINA SCHOOL OF THE ARTS TWICE RECLASSIFIED A POSITION IN THE PERSONNEL DEPARTMENT WITHOUT THE APPROPRIATE APPROVAL OF THE UNIVERSITY OF NORTH CAROLINA OFFICE OF THE PRESIDENT AND THE OFFICE OF STATE PERSONNEL.

On March 1, 1999, the North Carolina School of the Arts (NCSA) created a new EPA (Exempt from the State Personnel Act) position for the Director of Human Resources without abolishing the existing SPA (Subject to the State Personnel Act) Personnel Officer II position. On May 1, 1999, a Personnel Technician II received an acting promotion to the Personnel Officer II position to serve as interim Human Resources Director and received a 15% salary increase. On June 1, 1999, the acting promotion was made permanent and the employee's former Personnel Technician II position was abolished. Effective September 9, 1999, NCSA hired an individual for the newly created EPA Human Resources Director position, effectively creating two filled Director of Human Resources positions.

In a January 2000 letter to NCSA, the Associate Vice President for Faculty and Staff Resources for the University of North Carolina Office of the President (UNC) stated that she was aware NCSA had converted its Assistant Director of Human Resources position (the Personnel Officer II position) from an SPA to an EPA position without appropriate authorization from UNC or the North Carolina Office of State Personnel (OSP). As she explained, "A position may be designated as EPA only if it has been approved as Instructional, Research, or Senior Academic and Administrative Officer." The letter was to serve as NCSA's notice that the "Assistant Director position

FINDINGS AND RECOMMENDATIONS (CONTINUED)

must revert immediately to a SPA position and that you (NCSA) must obtain approval from the NC Office of State Personnel for the appropriate SPA classification and compensation for this position.”

In another January 2000 letter to NCSA, the Director of OSP’s Personnel Services Division said the original Personnel Officer II position should have been abolished when the Human Resources Director position was created because, “the two positions were identical in the role of Director of Human Resources.” He also said at the time the new Human Resources Director was hired, or within a transition period of not more than 30 days, the Personnel Officer II should have returned to her previous Personnel Technician II position and her salary reverted to its original amount plus any legislative increase or career growth recognition she may have been due. In this letter, the Personnel Services Division Director said he had previously discussed this issue with NCSA’s Human Resource Director in November 1999. He said in December he became aware the employee had not returned to her original Personnel Technician II position but NCSA converted the Personnel Officer II position into a new EPA position and granted the employee another 15% raise. He also learned at that time, NCSA had not received the required approval from UNC for this conversion. He directed the Human Resources Director to “act quickly” in resolving the situation and suggested the employee return to her former Personnel Technician II position or to provide documentation to support a

FINDINGS AND RECOMMENDATIONS (CONTINUED)

possible reallocation to a Personnel Technician III. He also stated that a payback situation probably existed for the employee. The Director of OSP's Personnel Services Division sent a second letter to NCSA's Human Resource Director in April 2000. This letter was a follow-up to a March 24, 2000, telephone call and the earlier letters from OSP and UNC. The letter expresses "...concern with the continuing delay in appropriately classifying the position," and the Associate Vice President for Faculty and Staff Resources at UNC, "...concerns over the EPA designation of the position as indicated in her earlier letter...." He also wrote he had not received a response from his January 12, 2000, letter to NCSA.

On May 19, 2000, the Associate Vice President for Faculty and Staff Resources at UNC wrote to NCSA's Vice Chancellor for Finance and Administration denying his request for EPA Senior Academic and Administrative Officer designation for the position. She wrote, "I again reiterate that this position must revert immediately to a SPA position and that you must obtain approval from the NC Office of State Personnel for the appropriate SPA classification and compensation level. Please be advised that an adjustment in salary and possible salary repayment by the affected employee may be necessary."

In September 2003, NCSA transferred the employee in the SPA Assistant Director of Human Resources position to a new EPA position, the Special Assistant to the Vice Chancellor for Finance and Administration. Again the Associate Vice President for Faculty and Staff Resources at UNC issued a letter to NCSA stating she had become

FINDINGS AND RECOMMENDATIONS (CONTINUED)

aware of the transfer to the new position and neither OSP or UNC authorized EPA classification for this new position. The Associate Vice President for Faculty and Staff Resources directed NCSA to return the employee to her former SPA position and eliminate the Special Assistant to the Vice Chancellor for Finance and Administration position. She also stated, “I am concerned about this repeated action at North Carolina School of the Arts and disappointed that your institution has not taken steps to correct the situation after we discussed it several months ago.”

According to NCSA’s Director of Human Resources⁵, the Vice Chancellor for Finance and Administration⁶ had the Personnel Analyst reclassify her own position and four others from SPA to EPA classification. The Human Resources Director said he was not aware of the changes and the Personnel Analyst had not gone through the proper channels to have the positions reclassified. NCSA returned the positions to their original classifications after being told by UNC that those changes were not made in the appropriate manner. When questioned about this issue, the Personnel Analyst stated she had undergone a position change in September 2003 and would be reverting to her previous SPA position effective March 2004.

From May 1, 1999 to July 1, 2004, the Personnel Analyst received three promotions that were not approved by UNC and OSP. She was reassigned to her Personnel Analyst position on July 1, 2000, but we found no evidence that any paybacks were ever made.

⁵The Director of Human Resources resigned from his position with the North Carolina School of the Arts effective October 31, 2004.

⁶The Vice Chancellor For Finance and Administration resigned from his position with the North Carolina School of the Arts on July 13, 2004.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

**Table of Personnel Actions for Personnel Analyst
May 1, 1999 – July 1, 2004**

| Date | Action | Paygrade | Position Type | Percentage Increase/ (Decrease) | Dollar Increase/ (Decrease) | Salary |
|----------|---------------------------------|----------|---------------|---------------------------------|-----------------------------|-----------|
| 04/30/99 | | 66 | SPA | | | \$ 39,403 |
| 05/01/99 | Acting Promotion | 74 | SPA | 15.0 % | \$ 5,910 | 45,313 |
| 06/01/99 | Acting Promotion Made Permanent | 74 | SPA | | | 45,313 |
| 07/01/99 | COLA | | | 1.0 % | 453 | 45,766 |
| 07/01/99 | CGRA | | | 2.0 % | 906 | 46,672 |
| 12/01/99 | Promoted | FR | EPA | 5.0 % | 2,337 | 49,009 |
| 07/01/00 | Reassigned | 66 | SPA | (0.76) % | (377) | 48,632 |
| 07/01/01 | COLA | 66 | SPA | 1.29 % | 625 | 49,257 |
| 09/01/03 | Promoted | FR | EPA | 11.66 % | 5,743 | 55,000 |
| 03/01/04 | Re-assigned | 66 | SPA | (11.66) % | 5,743 | 49,257 |
| 07/01/04 | Legislative Increase | 66 | SPA | 2.50 % | 1,231 | 50,488 |

Source: State Personnel Management Information System

COLA- Cost-of-Living Adjustment

CGRA- Career Growth Recognition Award

FR-Flat Rated (Salaries set by means other than OSP graded salary schedules)

The authority to designate a position as EPA lies with the Office of the President for the University of North Carolina and/or the Office of State Personnel. The University of North Carolina Policy Manual Chapter 300.1.2, *Evaluation of Positions for Designation as Senior Academic and Administrative Officer*, requires the Chancellor to submit a detailed description of the position including assigned authority and responsibilities along with an organizational chart for the unit for authorization to classify a position as EPA.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

RECOMMENDATION

We recommend NCSA adhere to all relevant UNC and OSP personnel policies and procedures for appropriate designation of EPA positions. The Human Resources Director should contact the Office of State Personnel or the UNC Office of the President for guidance on procedures when questions arise. In addition, NCSA should expedite corrective action in a timely manner when directed by either OSP or the UNC Office of the President. We reiterate the position stated by UNC that if any other unauthorized EPA positions exist on campus, the School should take steps to return the positions to the appropriate designation. Also, we recommend UNC review the personnel actions for the Personnel Analyst and consult with the North Carolina Attorney General's Office concerning the process for requesting any possible salary repayments, as provided by G.S. §143-64.80 (Exhibit).

2. FROM MAY 2001 THROUGH SEPTEMBER 2003, NCSA PAID THE PERSONNEL ANALYST \$69,112.34 FOR OVERTIME, WHICH APPEARS EXCESSIVE AND LACKS ADEQUATE SUPPORTING DOCUMENTATION. THIS AMOUNT INCLUDES \$22,753.21 IN INCORRECT CALCULATIONS FOR OVERTIME HOURS EARNED.

From May 2001 through September 2003, the Personnel Analyst was paid \$69,112.34 in overtime payments in addition to her annual base salary that ranged from \$48,632 to \$55,000 (Schedule 1). This amount includes \$22,753.21 in incorrect calculations for overtime hours earned. The errors in calculation appear to be the result of several issues including improper documentation, mathematical miscalculations and human error.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

The overtime payments were initiated through memos prepared by the Personnel Analyst, signed by her supervisor and sent to the payroll department. Timesheets were not submitted with most of the memorandums. Only two memorandums submitted during 2001 had supporting timesheets. In some instances, the overtime payments requested in the memorandums did not agree with the overtime earned as shown on the employee's timesheet.

In addition, many of the employee's timesheets were not completed in detail. Six of the timesheets reviewed were not signed by the Personnel Analyst's supervisor. In one instance, the timesheet's daily breakdown does not reveal any overtime earned but the monthly summary included compensatory time earned at time and one-half. For example, the daily breakdown on the employee's June 2001 timesheet shows 0 hours overtime earned. However, the monthly summary has the employee earning 75 hours (112.5 hours at time and one-half) in overtime for the month. No documentation for this time earned is provided except for the handwritten note "Comp time 75 hours earned due to HRS project" on the timesheet.

After June 2001, the Personnel Analyst quit recording actual hours worked on a daily basis. It appears that only hours worked over her regular schedule were recorded on the timesheet in the daily hours worked column.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

After January 2002, no hours were recorded on a daily basis on the employee's timesheets. The only evidence of overtime was located in the summary for compensatory and leave time earned/taken. There is no way to determine if the hours earned were during weeks when more than 40 hours were actually worked. The State Personnel Manual states, "The payment of premium time and one-half rates in form of monetary compensation or time off is required for hours worked in excess of 40 within a week..." Therefore, on weeks the employee did not actually work 40 hours, any overtime should have been earned on an hour-for-hour basis. For weeks in which the employee actually worked more than 40 hours, overtime should have been earned at time and one-half. However, the timesheets lack enough detail to indicate which basis should have been used to calculate payment due.

Correspondingly, the memorandums authorizing the overtime payments stated the overtime due had already been calculated at time and one-half through April 2002. However, in subsequent months, the memos only stated the number of overtime hours for which the employee should be paid. The memos for May, June and July 2002 included a hand-written note from the Personnel Analyst that the overtime hours reported did not include time and one-half. The memos subsequent to July 2002 no longer indicated whether the hours had already been converted into time and one-half for payment and no accompanying timesheets were submitted.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

It appears the Payroll Clerk receiving the memos entered the amounts listed in the memos subsequent to April 2002 and multiplied those by time and one-half to determine overtime earned for the Personnel Analyst. When questioned by auditors, the Personnel Analyst offered to repay the \$22,753.21 in computation errors through payroll deductions.

The Payroll Clerk who received the memorandums said she questioned the Assistant Controller about the amount of overtime the Personnel Analyst earned but was told not to question information submitted by Human Resources. The Payroll Clerk then spoke with the Assistant Vice Chancellor for Special Projects who referred her to the Controller and Associate Vice Chancellor for Finance and Budget. The Payroll Clerk prepared an analysis of the Personnel Analyst's overtime for calendar year 2002 and submitted it to the Associate Vice Chancellor and spoke with the Controller. According to the Payroll Clerk the issue was not discussed again.

Regarding the significant amount of overtime payments made to the employee, the Vice Chancellor for Finance and Administration stated a former payroll clerk left in 2001 giving only a two-week notice. The new payroll clerk lacked experience with the central payroll system and generated several errors when preparing her first three payrolls. After receiving complaints from employees, the Vice Chancellor said he approached the Human Resources Director and inquired about having the Personnel Analyst review the monthly payrolls for which he would authorize overtime.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

The Vice Chancellor said the Personnel Analyst was verifying changes in the payroll file, including deductions, new employees, pay rates, etc. He said he did not monitor the Personnel Analyst's activities and trusted the Human Resources Director would be doing so.

The Human Resources Director verified the Vice Chancellor requested the Personnel Analyst review the payroll. At that time, the Personnel Analyst began presenting memos for him to sign approving her overtime. The Human Resources Director said he did sign the memos, but considered the Personnel Analyst to be working for the Vice Chancellor, as a result he does not know if she actually worked the hours.

The Human Resources Director said the Personnel Analyst performed between 80-100 overtime hours preparing the Personnel Data File and implementing the HRS Data System for the Human Resources Department. He estimated reviewing of the payroll file might take approximately 30 hours per month, but he really did not know. He said the overtime hours accumulated by the Personnel Analyst appeared excessive to him, but considered her to be working for his supervisor, the Vice Chancellor for Finance and Administration.

The Controller estimated the Personnel Analyst could have reviewed the payroll in less than one day per month.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

When questioned regarding the amount of overtime earned, the Personnel Analyst stated she reviewed the payroll register to verify monthly personnel action forms were accurately reflected on the register. She stated she would take the registers home at night and work on average 4-5 hours per month. She would inform the Assistant Controller or the Payroll Clerk of any errors she noted. She did not prepare reports or memos documenting the errors and required changes. When asked why she earned 135 hours of overtime in February 2003, if the review of the register only took 5 hours per month, she said she could not remember. When questioned if any evidence to support the overtime hours existed, she said the payroll registers she used were shredded. The Personnel Analyst could not identify any special projects she had worked on other than the Personnel Data File and payroll review.

Additionally, the Personnel Analyst could not explain why she ceased to document the actual hours worked on her timesheets.

RECOMMENDATION

We recommend NCSA ensure proper documentation is maintained to support overtime hours earned by its employees. Such documentation would include detailed and accurate timesheets, appropriate authorization and approval, and reason for overtime earned as well as reports/documents generated during the overtime hours worked. Supervisors should be aware of the amount and reason for overtime hours worked by subordinates. Overtime hours earned should be monitored to ensure hours claimed are actually worked.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Timesheets should be attached to requests for overtime payments and be reviewed to ensure mathematical accuracy and proper tracking of overtime hours earned and paid. Special care should be taken to ensure that overtime earned at time and one-half is only computed at this rate one time to avoid overpayment. With regards to the existing overpayments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning the process for requesting reimbursement, as provided by G.S. §143-64.80 (Exhibit).

3. FROM DECEMBER 2001 THROUGH JANUARY 2004, THE SCHOOL OVERPAID A PERSONNEL ASSISTANT \$5,265.32 FOR INCORRECT OVERTIME CALCULATIONS.

The Personnel Assistant received a total of \$15,742.04 in overtime payments from 2001 through January 2004 (See Schedule 2). The Director of Human Resources said the Personnel Assistant earned the overtime entering data into their system and he believed the time earned reflected the actual time worked. The Personnel Assistant's timesheets did include details about daily hours worked. However, the timesheets were not attached to the memos authorizing the payment for overtime earned. The memos submitted to her supervisor were prepared by the Personnel Analyst and often included the overtime hours for both employees. As stated in finding 2, after April 2002, these memos no longer stated that time and one-half had already been calculated for the hours earned. As a result, the overtime was improperly entered into the system at time and one-half then recalculated again at time and one-half. Thus, NCSA overpaid the Personnel Assistant \$5,265.32.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

In several instances the number of overtime hours paid as reported on the memos do not agree with the number of overtime hours shown as paid (and deducted from the balance) on the employee's timesheets. Because the employee's timesheets were not attached and submitted with the memorandums, no comparison of the two occurred. If the timesheets had been submitted with the memorandums, the Payroll Clerk would have been aware the hours were already recorded at time and one-half, and ensured the overtime hours paid were accurately deducted from the balance.

RECOMMENDATION

We reiterate the need for NCSA to ensure proper documentation is maintained to support overtime hours earned by its employees. Such documentation would include detailed and accurate timesheets, appropriate authorization and approval, and reason for overtime earned as well as reports/documents generated during the overtime hours worked. Supervisors should be aware of the amount and reason for overtime hours worked by subordinates. Overtime hours earned should be monitored to ensure hours claimed are actually worked. Timesheets should be attached to requests for overtime payments and be reviewed to ensure mathematical accuracy in overtime hours computed and balances carried from month to month. Special care should be taken to ensure that overtime earned at time and one-half is only computed at this rate one time to avoid overpayment. With regards to the existing overpayments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning the process for seeking reimbursement, in accordance with G.S. §143-64.80 (Exhibit).

FINDINGS AND RECOMMENDATIONS (CONTINUED)

4. NCSA INAPPROPRIATELY PAID 20 SPA AND EPA EMPLOYEES SPECIAL ONE-TIME PAYMENTS TOTALING \$53,325.

From July 1, 2001, through June 30, 2003, six EPA and 14 SPA employees received special one-time payments (Schedule 3). These special one-time payments ranged from \$1,500 to \$5,000 and were based on memorandums from administrators to the individual responsible for processing the monthly payroll transmittal. The memos are brief and generally state the payments were for additional duties performed, without providing a detailed description of work performed and dates/times involved.

According to the Vice Chancellor for Finance and Administration, the payments made to EPA employees include a \$3,000 payment to the Assistant Vice Chancellor for Special Projects for performing internal audit duties, a \$2,000 payment to the Associate Vice Chancellor for Information Technologies for work on web site development, a \$3,000 payment to the Director of Facilities Management for serving as a consultant on a construction project and a \$2,000 special payment to the Associate Vice Chancellor for Finance and Budget for reasons he cannot recall. Note, the Associate Vice Chancellor for Finance and Budget said his special one-time payment was in lieu of a permanent salary increase. The Vice Chancellor for Finance and Administration said he has the authority to make one-time special payments to employees and the amount paid is at his discretion. He also said he has no documentation to support the payments.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

The Vice President and General Counsel for the University of North Carolina said no university system policy exists for one-time payments to EPA employees. She said in her opinion the payments are appropriate if the employee is taking on additional duties and responsibilities on a temporary basis. As stated above, most of the memorandums do not provide detailed descriptions of the work performed.

In the instances when the memos indicate the type of work performed, the work appears to fall within the scope of the employee's normal duties, making the reason for payments in addition to the employee's salary questionable. For example, the memo requesting payment to the Controller states the work was for "...working additional hours due to the changing of the reporting model of the financial statements."

Of the 14 SPA employees awarded one-time special payments, nine are SPA employees who are not subject to the Fair Labor Standards Act, but received a total of \$20,740.22 in one-time special payments. According to the Office of State Personnel Policy Manual, SPA employees exempt from the Act can earn compensatory leave time on an hour-for-hour basis, but cannot be paid additional compensation.

The remaining five SPA employees who received one-time payments are subject to the Fair Labor Standards Act. SPA employees who are subject to the Act should be paid in accordance with Fair Labor Standards Act overtime requirements and receive no additional compensation except for dual employment and true in-range adjustments for

FINDINGS AND RECOMMENDATIONS (CONTINUED)

additional duties assumed. SPA employees subject to the Act must be paid a premium rate (time and one-half) in the form of monetary compensation or time off for hours worked in excess of 40 within the workweek. Overtime hours worked during weeks in which the employee did not actually work 40 hours should be paid hour-for-hour.

The Personnel Analyst referenced in a previous finding was included in the SPA employees subject to the Act receiving one-time special payments. Not only was this employee ineligible for compensation other than overtime pay, the one-time payments appear to be related to the same work for which the employee was paid overtime. During the time she was paid \$69,112.34 for overtime, the Personnel Analyst also received two one-time payments, one in March 2002 for \$5,000 and one in January 2003 for \$3,500 (Schedule 1). When questioned, the Vice Chancellor for Finance and Administration said he does not recall why this employee received one-time special payments when she was already being paid for overtime.

RECOMMENDATION

We recommend NCSA discontinue paying one-time payments to SPA employees who are ineligible to receive such compensation. SPA employees subject to the Fair Labor Standards Act should be compensated with time or money earned at the time and one-half rate for all hours worked over 40 during the week. SPA employees not subject to the Act should earn compensatory leave on an hour-for-hour basis for all time worked over 40

FINDINGS AND RECOMMENDATIONS (CONTINUED)

hours. OSP procedures should be followed in the cases where additional compensation is merited for dual employment, in-range adjustments and acting promotions. All overtime earned should be adequately documented on employees' timesheets and approved by supervisors. Supervisors should be aware of duties performed outside of employees' regular schedules to ensure accuracy in recording and the true need for hours earned.

We recommend the University of North Carolina develop a written policy addressing one-time special payments to EPA employees in order to ensure consistency among the 16 constituent institutions. If the University of North Carolina determines the payments are appropriate, the policy should require adequate documentation be submitted with payment requests and maintained to support the reason for and the accuracy of one-time payments.

With regards to the questionable one-time special payments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning repayments by employees, as provide by G.S. §143-64.80 (Exhibit).

5. THE PERSONNEL ANALYST APPROVED PERSONNEL ACTIONS, INCLUDING OVERTIME AND ONE-TIME PAYMENTS FOR HER SISTER.

The Personnel Analyst's sister worked for the Associate Director of the Kenan Institute for the Arts, a program funded by the Kenan Funds for the Arts. In May 2002, the Personnel Analyst received a memorandum requesting \$500 be withheld from her sister's paycheck from May through December 2002 to reduce the sister's compensation for three days that would not be worked each month. In September 2002,

FINDINGS AND RECOMMENDATIONS (CONTINUED)

the Personnel Analyst received and processed a request for a \$2,000 one-time special payment to her sister. On this memorandum a handwritten note by the Personnel Analyst states, "Do not deduct \$500 payment." No deductions were taken from her sister's September – December 2002 paychecks as authorized by the May 2002 memo. Additionally, the Personnel Analyst received and processed a second one-time payment to her sister in the amount of \$1,685.60 for work on a summer project.

RECOMMENDATION

We recommend no NCSA employees be involved in the authorization of payroll changes for immediate family members.

6. EMPLOYEES APPEAR TO BE ABUSING THE EMPLOYEE LOAN PROGRAM BY TREATING THE FUNDS AS REVOLVING LINES OF CREDIT, EXCEEDING ALLOWED LOAN AMOUNTS AND FAILING TO REPAY LOANS WITHIN THE REQUIRED TIME LIMIT.

During the process of examining the overtime paid to the Personnel Analyst, we noted deductions from her NCSA earnings for loan repayments to the North Carolina School of the Arts Foundation, Inc. Further examination revealed the existence of a loan fund in the Foundation that was established through a donation to help faculty and staff with moving expenses and employee emergency loans. According to the Director of Budget (Foundation Controller), \$60,000 was donated to the Foundation with the stipulation that the money would be used for employee loans. The donation agreement requires that 85% of the \$60,000 (\$51,000) be available in increments from \$2,000 to \$9,999 to recruited

FINDINGS AND RECOMMENDATIONS (CONTINUED)

faculty and staff to help with moving expenses. The loans for recruitment are interest free and recipients have from one to three years to repay the funds. The remainder of the \$60,000 (\$9,000) is to provide emergency loans to NCSA employees. The emergency loans are available up to \$1,000 per employee, interest free and require repayment within 12 months. The guidelines for the Foundation loan fund include unexpected death in the family, sudden accident or illness and unusual personal financial emergencies as examples of acceptable uses for emergency loans.

To receive an emergency loan, an employee sends a request to the Chancellor. The Chancellor forwards the information to Human Resources to verify the employee retains a full time employment status. The employee signs an agreement and a payroll withholding form and a check is issued.

Review of loan fund documentation indicates employees are abusing the emergency loan privilege. We reviewed documentation provided by the Foundation Controller for seven employees who have received emergency loans since 1995. Of the seven reviewed, all seven kept renewing their original loans without completely paying off the former funds borrowed. Prior to the paying off the loan balance, some employees would request new loans that included funds to pay off the balance on the original loans. Loan fund guidelines require that "All loans will be short-termed...Emergency loans up to \$1,000 may be granted with repayment within twelve months." In several instances, we

FINDINGS AND RECOMMENDATIONS (CONTINUED)

identified employees that continually had balances for up to four consecutive years. Additionally, we noted three employees whose balances (at times) exceeded the \$1,000 limit.

Furthermore, in August 1999, the Personnel Analyst referred to in prior findings received a \$3,000 advance on an expected one-time payment for serving as Acting Director of Human Resources. The Vice Chancellor for Finance and Administration issued a memorandum dated August 10, 1999, to the Foundation Controller to advance the Personnel Analyst, "a loan of \$3,000 that will be repaid later...The bonus is the differential in pay for a Director of Human Resources. The repayment of this advance will occur when the paperwork is processed through the Office of State Personnel." The loan was paid from the Business Office Discretionary funds within the Foundation and not by funds referred to above. The Personnel Analyst signed a Faculty-Staff Loan Fund Promissory Note for \$3,000 on August 20, 1999. The Foundation Controller said the advance was documented on the loan fund spreadsheet to have all loans documented in one place. The Foundation Controller said it was her belief the advance would be repaid through payroll deductions.

As of November 30, 1999, the advance had not been repaid, as a result the Foundation Controller issued a memo instructing the Payroll Clerk to add \$3,000 to the Personnel Analyst's W-2 form as additional income. The Vice Chancellor for Finance and Administration later instructed the Foundation Controller to delete the additional income from the Personnel Analyst's W-2. On December 12, 2000, after receiving no payments

FINDINGS AND RECOMMENDATIONS (CONTINUED)

from the Personnel Analyst, the Foundation Controller issued another memo adding the \$3,000 to the Personnel Analyst's W-2 as additional income. The Vice Chancellor for Finance and Administration approved this action and instructed the Foundation Controller to forgive the Personnel Analyst's loan.

The loan guidelines state, "All loans must be paid in full – no portion under any circumstances will be forgiven. The loan is not to be construed as income, nor as a grant, nor as a gift, nor as a means to avoid taxes, but only as a loan to assist an employee and not to be used in lieu of salary or other benefits normally available."

RECOMMENDATION

Management should enforce the loan fund guidelines regarding legitimate use of loan funds, timely repayment of loans and allowable loan amounts. Measures should be taken to ensure employees are not allowed to treat the emergency loan program as a revolving line of interest free credit.

7. STATE AND FOUNDATION FUNDS WERE USED TO IMPROPERLY FUND DISCRETIONARY ACCOUNTS NOT REPORTED TO THE FOUNDATION BOARD OF DIRECTORS.

During our examination of employee loans made by the Foundation, it came to our attention that three accounts existed in the Foundation records that were not included in its budget or disclosed to the Foundation board members. These accounts were titled:

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Chancellor's Discretionary – Restricted (Project ID 1002), Business Office Discretionary (Project ID 1000), and NCSA Legal & Consult, (Project ID 1001). These accounts were funded as follows:

- Checks were written near fiscal-year end by the North Carolina School of the Arts to the Foundation to reimburse the Foundation for various expenses incurred during the year. The original expenses were paid from restricted accounts, such as, Film, Drama, Dance, and Music. The reimbursements were credited to the discretionary accounts instead of being credited to the Foundation accounts from which the expenses were originally paid.
- Expenditures from the discretionary accounts were concealed through the use of accounting journal entries that inappropriately reclassified expenditures to other Foundation accounts.

From July 1, 2001 to June 30, 2004, the following diverted reimbursements and inappropriate journal entries were made to the three accounts:

| <u>Account Description</u> | | <u>Diverted Reimbursements</u> | | <u>Inappropriate Journal Entries</u> |
|-----------------------------------|----|---------------------------------------|----|---|
| Chancellor's Discretionary | \$ | 203,853 | \$ | 30,999 |
| | | | | |
| Business Office Discretionary | | 15,900 | | 100,617 |
| | | | | |
| NCSA Legal & Consulting | | 0 | | 46,057 |
| | | | | |
| Totals | \$ | 219,753 | \$ | 177,673 |

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Expenses totaling \$269,224 were paid from the three accounts during the three-year period examined, including lease payments totaling \$15,000 for the lease of a Cadillac Escalade for the Vice Chancellor for Finance and Administration, who also served as Assistant Secretary and Assistant Treasurer on the Foundation Board, club memberships, cell phone bills, legal fees, consultant fees, gifts for employees and others, travel and meals.

According to the Foundation Controller, over the last three years she was instructed to create the Chancellor's Discretionary, the Business Office Discretionary and the NCSA Legal and Consulting accounts at the direction of the Vice Chancellor for Finance and Administration. She said she was told by both the Vice Chancellor for Finance and Administration and Associate Vice Chancellor for Finance and Budget to submit Foundation invoices to the school requesting reimbursements for payments for guest artists, equipment, and temporary employees, and to deposit the reimbursements in the Chancellor's Discretionary account for anticipated needs.

The Foundation Controller said that in separate discussions with the Vice Chancellor for Finance and Administration and the Associate Vice Chancellor for Finance and Budget she was told to "swap money" from restricted accounts to the discretionary accounts to cover commitments made by the Chancellor.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

According to the Foundation President, he did not know these accounts existed until June 11, 2004. After learning of the accounts, he requested the Chancellor to ask for the Vice Chancellor's temporary resignation as Assistant Secretary and Assistant Treasurer of the Foundation. In addition, the Foundation Board of Directors instructed the Foundation Controller to close the Business Office Discretionary account by June 30, 2004, and merge the Chancellor's Discretionary account and the NCSA Legal and Consulting accounts into the Chancellor's regular discretionary account.

According to the Vice Chancellor for Finance and Administration, who was also Assistant Secretary and Assistant Treasurer for the Foundation, he did not differentiate between accounts in the Foundation. He said he was not told which accounts originally paid the expenses or the accounts credited when the reimbursements were made. He said the money came from the Foundation and went back to the Foundation. The Vice Chancellor for Finance and Administration originally told us he instructed the Foundation Controller to create the Business Office Discretionary, the Chancellor's Discretionary, and the Legal and Consulting accounts. He later said he did not instruct the Foundation Controller to create the accounts. He said he discussed the account balances with the Chancellor on several occasions.

According to the Associate Vice Chancellor for Finance and Budget, he authorized the payment of invoices submitted by the Foundation, but he did not know how the funds were being managed by the Foundation.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

According to the Chancellor, he did not know the three accounts existed. He said he knew the Foundation provided him with a discretionary account with a budget of \$50,000 per year, but was never told about the other Chancellor's Discretionary Account, the Business Office Discretionary account, or the NCSA Legal and Consulting Discretionary Account.

The purpose of the NCSA Foundation is to support and supplement the North Carolina School of the Arts operations. In this situation, however, the Foundation was being reimbursed for its support and the reimbursements were funding discretionary accounts.

RECOMMENDATION

We recommend someone independent of the Vice Chancellor for Finance and Administration be appointed to manage the operations of the Foundation. In addition, we recommend the Foundation consult with legal counsel regarding any possible reimbursement.

- 8. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION RECEIVED IN EXCESS OF \$90,000 OVER 13 YEARS FROM THE NCSA FOUNDATION, INC., IN VIOLATION OF THE UNIVERSITY OF NORTH CAROLINA POLICIES. IN ADDITION, THE FOUNDATION CONTROLLER MISLED AUDITORS CONCERNING THE PAYMENTS.**

During our inquiries of the NCSA Foundation personnel concerning the employee loans referred to in finding 6, we were informed that a corporation owned by the Vice Chancellor for Finance and Administration was paid \$6,000 a year by the NCSA Foundation.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Further inquiries and research of NCSA Foundation records revealed that the Vice Chancellor for Finance and Administration, doing business as “Dickson and Associates”, entered into a consulting agreement with the N.C. School of the Arts Foundation, Inc. on August 1, 1991. The agreement stated that Dickson and Associates would provide “Financial and Administrative Services to the Foundation on a daily basis throughout the year and perform special projects as required by the Foundation Board.” The Foundation agreed to pay Dickson and Associates \$833 per month for the services provided. The President of the N.C. School of the Arts Foundation, Inc., and the Vice Chancellor for Finance and Administration signed the contract.

The Foundation Controller said that in May 1993, the Vice Chancellor for Finance and Administration gave her a copy of the *North Carolina School of the Arts Foundation Minutes of the Executive Committee Meeting (Executive Session)*, dated May 3, 1993, that stated, “... to award Joe Dickson an expense allowance of \$6,000 annually. This award will cover any expenses incurred by Mr. Dickson on carrying out his duties to the Board. Payment terms will be semi-annually beginning in May of 1993.” The Treasurer/Secretary of the Board signed the minutes.

The Foundation Controller said she later prepared a memo to herself from the Vice Chancellor For Finance and Administration dated January 31, 1996, stating,

Until further notice, please disburse my expense allowance, as approved by the North Carolina School of the Arts Foundation Board on May 3, 1993, payable to West End Associates, Inc. This payment is made semi-annually.

West End Associates, Inc has a consulting agreement with me and pays all my expenses directly...

FINDINGS AND RECOMMENDATIONS (CONTINUED)

From 1991 to 2004, the N.C. School of the Arts Foundation, Inc., paid the Vice Chancellor for Finance and Administration and his companies in excess of \$90,000. According to the Foundation Controller, an employee of the University of North Carolina General Administration (UNC-GA) visited the NCSA campus in the early 1990's and inquired about the payments to the Vice Chancellor for Finance and Administration. According to the Foundation Controller, shortly after the visit from the UNC-GA employee, the Vice Chancellor told her to start making the \$6,000 annual payment that he had been receiving to West End Associates, Inc, (a corporation formed by him). The Controller said she did not feel comfortable making the disbursement based solely on the Vice Chancellor's verbal instructions, so she prepared the January 31, 1996, memo from the Vice Chancellor to her and had the Vice Chancellor sign the memo.

According to the Foundation Controller, prior to the visit by the UNC-GA employee in the early 1990's, several employees, including herself received supplemental payments from the Foundation. After the visit by the UNC-GA employee, a directive was issued restricting supplemental payments from the Foundation to NCSA staff. According to the Foundation Controller, all payments to staff ceased at that time. However, payments were made to the Vice Chancellor for Finance and Administration through West End Associates, Inc., a company he incorporated.

According to the Foundation Controller, each year during the annual financial audit of the North Carolina School of the Arts, a State Auditor would ask her if the Foundation had

FINDINGS AND RECOMMENDATIONS (CONTINUED)

made any payments to the Vice Chancellor and other senior staff during the year. She said she would reply, “No.” She said after each inquiry she would tell the Vice Chancellor she did not feel comfortable replying that way to the State Auditors.

In October 1988, the President of the University of North Carolina issued a memorandum to the Chancellors of the 16 Constituent Universities stating it had come to his attention that some senior administrators in the system were being paid to serve as consultants to the institutions’ endowment funds. In the memorandum, the President said,

...this practice is not consistent with the statutory responsibility of the Board of Governors to “appoint and fix the compensation” of senior administrative officers.

Accordingly, senior officers may not be paid for service to the institution’s endowment board, or any entity organized under the aegis of the institution, such as foundations or associations...

On April 21, 1995, The University of North Carolina Board of Governors amended *The Policy Manual of The University of North Carolina* to include regulations regarding the compensation of Chancellors and senior administrators at the 16 Constituent Universities. The compensation regulations became effective July 1, 1995. The compensation regulations state:

The compensation of senior officers shall be set by the Board of Governors or a Board of Trustees delegated such authority by the Board of Governors.

No chancellor and no senior academic and administrative officer may be paid, in addition to his or her salary as established pursuant to the foregoing requirements, for any services rendered to any institution-related foundation, endowment, or other University-related enterprise.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Approximately 6 months after *The Policy Manual of The University of North Carolina* was amended to include the compensation regulation, the Vice Chancellor for Finance and Administration, who was also Assistant Secretary and Assistant Treasurer for the Foundation, instructed the Foundation Controller to stop making the \$6,000 annual payments to himself and begin making the payments to a business he had incorporated.

According to the Vice Chancellor for Finance and Administration, who was also Assistant Secretary and Assistant Treasurer for the Foundation, the \$6,000 per year payments were expense allowance payments. He said these types of payments are allowable under the University of North Carolina guidelines. He said the Foundation Treasurers signed the checks. He said he received a copy of the IRS form 1099 reporting the income each year.

The classification of a payment as an “expense allowance” requires the recipient to report the payments as income and deduct any Foundation-related expenses on their individual tax returns.

The current President of the Foundation Board of Directors said he did not know about the payments to the Vice Chancellor for Finance and Administration’s company until June 2004. He said the current and prior Foundation treasurers were aware of the payments. The Foundation Board terminated the payments at the June 23, 2004, meeting. The Chancellor said he was informed of the payments in the fall of 2003 and planned on terminating the payments in June 2004.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

RECOMMENDATION

We recommend the Foundation cease paying expense allowances, and instead reimburse NCSA employees directly for expenses incurred while conducting Foundation activities.

9. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION TRANSFERRED THE TITLE TO REAL PROPERTY WITHOUT AUTHORIZATION RESULTING IN THE MISAPPLICATION OF \$108,000 FROM THE NORTH CAROLINA SCHOOL OF THE ARTS FOUNDATION, INC.

Background

On April 18, 1985, the North Carolina School of the Arts Foundation, Inc. (the Foundation) acquired a 3.41-acre tract of land adjacent to the North Carolina School of the Arts (NCSA) from the City of Winston-Salem for \$66,885 for future expansion of the NCSA campus.

In November 2001, a Right-of-Way Agent for the North Carolina Department of Transportation (NCDOT) met with the Vice Chancellor for Finance and Administration, who was also Assistant Secretary and Assistant Treasurer for the Foundation, and the NCSA Chancellor to discuss the acquisition of a .65-acre right-of-way through the Foundation's 3.41-acre property for a road improvement project.

In December 2001, the Vice Chancellor for Finance and Administration met with an appraiser to arrange an inspection and appraisal of the Foundation's 3.41-acre property. The appraiser certified his report to NCDOT on January 22, 2002, and indicated the 3.41-acre property had a fair market value of \$519,900. The report also indicated the .65-acre right-of-way segment to be acquired by NCDOT had a fair market value of \$99,500.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

In February 2002, the NCDOT Right-of-Way Agent presented a \$99,500 offer to the Vice Chancellor for Finance and Administration for the acquisition of the .65-acre segment of Foundation property. The Right-of-Way Agent's Negotiating Diary includes notes indicating the Vice Chancellor for Finance and Administration intended to make a counteroffer and the Foundation was not willing to donate the land to NCDOT.

Foundation's Executive Committee Approves Property Transfer to NCSA

At a March 7, 2002, meeting of the Executive Committee of the Foundation, the Vice Chancellor for Finance and Administration, who was also Assistant Secretary and Assistant Treasurer for the Foundation, briefed members on the piece of land adjacent to the NCSA campus that was acquired by the Foundation in 1985. The official minutes from this meeting are as follows:

NCSA would like the Foundation to gift this property to the school in order to avoid potential liability to the Foundation when a parking lot is built on the land.

After discussion by the committee, a motion was made and passed to immediately transfer this property from the Foundation to the NCSA Endowment Fund by quit claim deed.

The minutes of the Foundation's Executive Committee meeting on March 7, 2002 do not reflect any discussion of the impending NCDOT acquisition or the appraised value of the Foundation's property.

Settlement with NCDOT and Transfer of Property to NCSA Program Support Corp.

On March 21, 2002, the Vice Chancellor for Finance and Administration agreed to a settlement amount of \$108,000 for the acquisition of the .65-acre section of the Foundation's property according to the Right-of-Way Agent's notes.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

On March 28, 2002, the Vice Chancellor for Finance and Administration acting as Secretary for the Foundation, executed a North Carolina Special Warranty deed, prepared by an attorney, to transfer title (without consideration) to the 3.41-acre property from the Foundation to the North Carolina School of the Arts Program Support Corporation (see organization overview). According to the Foundation President, the Vice Chancellor for Finance and Administration, who also served as Assistant Secretary and Assistant Treasurer for the Foundation, never disclosed this transfer of title to the Foundation's Board of Directors. The Foundation's Board of Directors authorized the transfer of title to the 3.41-acre property to NCSA, not to the NCSA Program Support Corporation.

Check Issued to NCSA Program Support Corporation

On May 15, 2002, NCDOT issued a check payable to the North Carolina School of the Arts Program Support Corporation for \$108,000. On May 22, 2002, the \$108,000 check was deposited in a local bank account in the name of the North Carolina School of the Arts Program Support Corporation. The subsequent expenditure of these funds included debt service payments, a \$25,000 down payment on a new residence for the NCSA Chancellor, and various other expenditures (see organization overview).

According to the Vice Chancellor for Finance and Administration, he transferred the property to the Program Support Corporation in order to avoid liabilities associated with potential soil contamination.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

RECOMMENDATION

The North Carolina School of the Arts Foundation should seek reimbursement for the \$108,000 deposited in the North Carolina School of the Arts Program Support Corporation's checking account.

10. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION MISAPPLIED \$177,945 FROM THE NORTH CAROLINA SCHOOL OF THE ARTS FOUNDATION, INC., THROUGH THE TRANSFER OF OWNERSHIP AND SUBSEQUENT DISPOSITION OF REAL PROPERTY.

Background

In the early 1990s, officials with the North Carolina School of the Arts (NCSA) met with one of NCSA's principal benefactors to discuss a plan to provide housing for guest artists near the NCSA campus. The benefactor purchased five houses on Chapel Street, adjacent to the NCSA campus, and donated them to the North Carolina School of the Arts Foundation, Inc., (the Foundation) over a seven-year period from 1992 to 1999.

By 2003, NCSA had developed a university master plan for the expansion and improvement of its Winston-Salem campus. The houses on Chapel Street became part of this plan because of their location and the fact that NCSA could maintain the properties with building reserve funds.

In response to a request from NCSA, the University of North Carolina Office of the President approved the acquisition of the five Chapel Street houses on October 14, 2003. The approval was subject to the condition that the acquisition cost could not exceed the Foundation's purchase price and final approval from the Council of State.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Council of State's Approval of the Acquisition of the Chapel Street Houses

On October 29, 2003, an NCSA Project Manager, under the supervision of the Vice Chancellor for Finance and Administration, issued a request to the State Property Office for the reimbursement of \$177,945 in maintenance and repair costs associated with the Chapel Street houses in exchange for the Foundation's transfer of the properties to NCSA.

The State Property Office employee responsible for processing the NCSA request provided the following statement to us about the Chapel Street houses:

The North Carolina School of the Arts, requested that this office acquire the above referenced properties [the Chapel Street houses] from the North Carolina School of the Arts Foundation for inclusion in their university master plan. The subject properties were submitted to the Joint Legislative Commission on Governmental Operations for their favorable recommendation to the Governor and Council of State. On February 3, 2004 the Governor and Council of State approved the acquisition of the properties from the NC School of the Arts Foundation, Inc.

The Council of State approved the acquisition of the Chapel Street houses for \$177,945 in accordance with the NCSA request. Documents from the Council of State meeting included the following comments:

The above consideration represents the cost incurred by the Foundation for improvements and maintenance of the property. Property proposed for acquisition will be utilized in accordance with the university master plan, which will allow for construction of parking facilities.

Check Request from State Property Office

On March 16, 2004, the State Property Office issued a memorandum to the NCSA Project Manager requesting that checks be prepared and forwarded to a designated attorney for

FINDINGS AND RECOMMENDATIONS (CONTINUED)

the acquisition of the Chapel Street houses from the Foundation. On March 26, 2004, NCSA issued five checks to the closing attorney totaling \$177,945 for the acquisition of the Chapel Street houses.

Statement from the President of the Foundation

The President of the Foundation Board provided the following statement about the Foundation Board's knowledge of transactions related to the Chapel Street houses:

I first heard about the Chapel Street houses on April 15th [2004] when the Foundation Accountant made an off-hand comment about them being transferred from the Foundation to the School [NCSA]. I called [the Vice Chancellor for Finance] to find out about the assets and the transaction. I met [the Vice Chancellor for Finance] on Monday, April 19th to inspect the houses and discuss the transaction. I asked [the Vice Chancellor for Finance] to make a presentation to the Foundation Board's Executive Committee at its next meeting (May 5, 2004). He informed me that the transfer was scheduled to close that Friday (April 23, 2004). I told him to cancel the closing and make the presentation on May 5th.

Foundation Board Executive Committee Meeting

In the May 5, 2004, Foundation Board's Executive Committee meeting, the Vice Chancellor for Finance and Administration, who also served as Assistant Secretary and Assistant Treasurer for the Foundation, made a presentation about the Chapel Street houses as requested. According to the official minutes from this meeting, the Vice Chancellor for Finance and Administration argued that the Chapel Street houses were becoming a financial burden to the Foundation and should be donated to NCSA because NCSA now had the funding to maintain them.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Further, he argued that Foundation funds budgeted for the maintenance of the Chapel Street houses could be used to rent apartments for guest artists at NCSA's Center Stage apartment complex.

The Foundation President recalled the following points from this meeting:

I asked him [the Vice Chancellor for Finance] why the Foundation should not just sell the properties and his response was that the land was part of the School's strategic plan to someday build a new library. Finally, [the Vice Chancellor for Finance] said the State would not pay the Foundation anything for the houses because they had been donated at zero cost.

Based on the information presented in this meeting, the Executive Committee approved a motion to transfer the Chapel Street houses to NCSA.

Chapel Street houses transferred to the NCSA Program Support Corporation

On May 24, 2004, the Vice Chancellor for Finance and Administration utilized five general warranty deeds to transfer ownership of the Chapel Street houses from the Foundation to the North Carolina School of the Arts Program Support Corporation (Program Support Corp.) without authorization from the Foundation's board of directors.

Checks Issued to Program Support Corp to Acquire the Chapel Street Houses.

On May 28, 2004, the attorney issued five checks totaling \$177,585 to the Program Support Corporation for the acquisition of the Chapel Street houses. The checks were deposited in a Program Support Corp. checking account on June 1, 2004.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

The Program Support Corp. is a tax exempt organization established in July 1997 to support NCSA. Its board members are the NCSA Chancellor, the NCSA Vice Chancellor for Arts and Academics, and the Vice Chancellor for Finance and Administration.

According to the Vice Chancellor for Finance and Administration, he transferred the properties to the Program Support Corporation in order to avoid liabilities associated with potential soil contamination.

Summary

The Council of State approved the acquisition of the Chapel Street houses from the Foundation for \$177,945 on February 3, 2004. When the Vice Chancellor for Finance and Administration, who also served as Assistant Secretary and Assistant Treasurer for the Foundation, made his presentation about the Chapel Street houses to the Executive Committee of the Foundation Board on May 5, 2004, he failed to disclose this information. According to the Foundation President, the Vice Chancellor for Finance and Administration told the Executive Committee the State could not pay for the Chapel Street houses because the houses were donated to the Foundation. The Executive Committee subsequently approved the donation, not the sale, of the Chapel Street houses to NCSA. Moreover, there was no approval from the Foundation's Executive Committee to transfer ownership of the Chapel Street houses to the Program Support Corporation.

RECOMMENDATION

The Foundation should seek reimbursement of \$177,945 from the NCSA Program Support Corporation.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

11. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION AND THE DEAN OF THE SCHOOL OF FILMMAKING RECEIVED COMPENSATION FROM NCSA UNITY DEVELOPMENT CORPORATION IN VIOLATION OF UNIVERSITY OF NORTH CAROLINA REGULATIONS.

Background

NCSA Unity Development Corporation (Unity Development) filed its Articles of Incorporation with the North Carolina Secretary of State on January 13, 2003. These Articles of Incorporation state the purpose of Unity Development is “to operate for the benefit of, to perform the functions of, or to carry out the purposes of the North Carolina School of the Arts (NCSA).” The initial board of directors for Unity Development was comprised of the NCSA Chancellor, the NCSA Vice Chancellor for Finance and Administration and the NCSA Provost and Vice Chancellor for Arts and Academic Programs. Subsequently, five people not employed by NCSA were appointed to the board of directors and the Vice Chancellor for Finance and Administration tendered his resignation as a voting member to the board because he was being compensated for his services.

The Unity Development checkbook was maintained by the Executive Assistant to the Vice Chancellor for Finance and Administration in her office. She was responsible for processing invoices and preparing checks.

At a September 25, 2003, meeting of the Unity Development Board of Directors, motions were made and passed to compensate the Dean of the School of Filmmaking \$30,000 per year and the Vice Chancellor for Finance and Administration \$27,096 per year for services provided to Unity Development.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Payments to Green Street Productions, Inc.

Unity Development issued a check for \$20,000 on November 25, 2003, for consulting services to Green Street Productions, Inc., a corporation created in November 2003 by the Dean of the School of Filmmaking. On July 28, 2004, Unity Development issued a second check to Green Street Productions, Inc. for \$9,400. The Dean of the School of Filmmaking is listed as the president of Green Street Productions, Inc. in an annual report filed with the North Carolina Secretary of State.

Payments to West End Associates, Inc.

Between October 2003 and July 2004, Unity Development issued checks totaling \$38,323.45 for consulting services to West End Associates, Inc., a corporation established by the Vice Chancellor for Finance and Administration in 1995.

According to the Chancellor, the Vice President and General Counsel for the University of North Carolina approved the process of Unity Development paying the Vice Chancellor for Finance and Administration and the Dean of the School of Filmmaking, as long as they performed the services on their own time.

According to the Vice President and General Counsel for the University of North Carolina, she advised the Chancellor in an email on September 8, 2003, that it did not appear improper to her for the Dean of the School of Filmmaking to receive compensation from Unity Development “as long as it is clear that the Dean must do all of the work on

FINDINGS AND RECOMMENDATIONS (CONTINUED)

his own time and not utilizing University resources.” In subsequent emails in December 2003, the Vice President and General Counsel for the University of North Carolina and the NCSA Attorney agreed that Section 300.1.1. of the *University of North Carolina Policy Manual* did not apply to the Dean of the School of Filmmaking.

Since (1) Unity Development’s purpose is different than that of a typical university foundation whose sole purpose is to support the university/school; (2) NCSA does not control Unity Development either by appointing directors or through overlapping boards; and (3) the consulting activities are different from the duties normally performed by the Dean for NCSA.

According to the Vice President and General Counsel for the University of North Carolina, she was never asked if she thought Section 300.1.1. of the *University of North Carolina Policy Manual* applied to the Vice Chancellor for Finance and Administration receiving compensation from Unity Development.

According to the Vice Chancellor for Finance and Administration, the Vice President and General Counsel for the University of North Carolina approved for both the Dean of the School Filmmaking and himself to receive compensation from Unity Development for their services.

According to the Dean of the School of Filmmaking, he was assured by the Chancellor that the compensation he received from Unity Development would not violate UNC policies.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Violation of University of North Carolina Policy

As a constituent institution of the University of North Carolina, employees of NCSA are subject to its policies and regulations. Section 300.1.1 of the *University of North Carolina Policy Manual* includes specific regulations for senior academic and administrative officers of the University of North Carolina. The following regulation specifically addresses the compensation of senior officers.

The compensation of senior officers shall be set by the Board of Governors or a Board of Trustees delegated such authority by the Board of Governors.

No chancellor and no senior academic and administrative officer may be paid, in addition to his or her salary as established pursuant to the foregoing requirements, for any services rendered to any institution-related foundation, endowment, or other University-related enterprise.

The Dean of the School of Filmmaking and the Vice Chancellor for Finance and Administration are senior academic and administrative officers, respectively, of NCSA as defined in Section 300.1.1 of the *University of North Carolina Policy Manual*. Unity Development is an institution-related enterprise by reference to its *Articles of Incorporation*, and the control of its financial activities by the Vice Chancellor for Finance and Administration. Therefore, in our opinion, the compensation paid by NCSA Unity Development Corporation to the Dean of the School of Filmmaking and the Vice Chancellor for Finance and Administration, through their corporations, represents a violation of the above regulation of the University of North Carolina.

FINDINGS AND RECOMMENDATIONS (CONCLUDED)

RECOMMENDATION

The North Carolina School of the Arts should develop and implement management controls to ensure compliance with regulations adopted by the Board of Governors of the University of North Carolina. In addition, the Office of the President of the University of North Carolina should firmly emphasize the importance of its regulations and the consequences of noncompliance.

CONCLUSION

The eleven findings on the North Carolina School of the Arts reveal:

- a series of personnel actions that violate regulations and policies and demonstrate poor administrative controls, and
- transactions involving the transfer of assets into discretionary accounts and other university related organizations that were not fully disclosed.

The personnel actions demonstrate a pattern of violations. The repetitive nature of the violations calls into question the School's continued designation as a special responsibility constituent institution as provided by North Carolina General Statute 116-30.1. Schools designated by the University of North Carolina Board of Governors as special responsibility constituent institutions receive management, budgetary and personnel flexibility beyond that normally enjoyed by state agencies. This designation is dependent upon the institution establishing and maintaining the "management staff and internal financial controls . . . to administer competently and responsibly all additional management authority and discretion" Maintaining this designation is dependent upon the absence of significant audit findings. Audit findings numbers one through five reveal a lack of control over State funds calling into question the School's fitness to maintain the designation of a special responsibility constituent institution.

The School also failed to exercise appropriate control or oversight over its related organizations. Loans to employees, compensation paid to senior school officials and the transfer of property between organizations demonstrate a lack of control and oversight. Particularly troubling are the transactions where real estate owned by the North Carolina

CONCLUSION (CONTINUED)

School of the Arts Foundation was transferred to another organization without full disclosure and compensation. The effect was to remove valuable assets from the North Carolina School of the Arts Foundation that were governed both by outside directors and school officials to an organization only governed by three-school officials.

Under recently established Governmental Accounting Standards Board guidelines, universities and institutions such as the North Carolina School of the Arts are required to disclose in their financial statements the financial activities of organizations they control or affiliated organizations whose assets and/or revenues are significant in comparison to the school. This office has been working with the University of North Carolina System to implement the new requirements. The activities of the organizations associated with the North Carolina School of the Arts clearly demonstrate the need for continuing vigilance in this area.

Given the totality of the circumstances surrounding the findings in this report we recommend:

- the North Carolina School of the Arts thoroughly and systematically strengthen its oversight of both personnel actions and foundation and related organization activities,
- the President carefully and fully review the School's designation as a special responsibility constituent institution and the attendant management flexibility, and
- the President of the University and the Board of Governors review its policies regarding foundations and related organizations associated with constituent institutions in the University of North Carolina system. More specifically we recommend the University of North Carolina and the Board of Governors require each institution to identify all foundations and related organizations and provide the University of North Carolina with a report of their activities including revenue and expenditures.

CONCLUSION (CONCLUDED)

Finally, we are referring this special review report in its entirety to the North Carolina Attorney General and the District Attorney for the 21st Prosecutorial District as provided by G.S. §147-64.6(c)(12) for their review to determine whether further action is warranted.

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STATEMENT OF QUESTIONED COSTS

The following schedule represents a quantification of the items examined during our special review. We cannot completely quantify the tangible benefits or detriment, if any, to the taxpayers resulting from the findings of our review. We simply are noting areas where managerial oversight should be enhanced, or where, in our judgment, questionable activities or practices occurred.

| | |
|--|---------------------------|
| 1. Overtime paid to Personnel Analyst that lacks adequate supporting documentation. | \$ 69,112.34 |
| 2. Incorrect compensation of overtime for a personnel assistant. | 5,265.32 |
| 3. Inappropriate one-time special payments | 53,325.82 |
| 4. The Personnel Analyst approved personnel actions, including overtime and one-time payments to her sister. | 3,685.60 |
| 5. Employees appear to be abusing the employee loan program. | 9,000.00 |
| 6. State and Foundation funds were used to improperly fund discretionary accounts not reported to the Foundation Board of Directors. | 397,426.00 |
| 7. The Vice Chancellor for Finance and Administration received compensation over 13 years from the NCSA Foundation, Inc. | 90,000.00 |
| 8. The Vice Chancellor for Finance and Administration diverted proceeds from the sale of real property without authorization. | 285,945.00 |
| 9. The Vice Chancellor for Finance and Administration and the Dean of the School of Filmmaking received compensation in violation of University of North Carolina regulations. | 67,723.45 |
| Total | <hr/> <u>\$981,483.53</u> |

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Personnel Analyst

| Payroll Period | Regular Salary | | One-Time Special Payments | Legislative Bonus | Overtime Payments | Longevity Payments | Gross Pay per Payroll Period |
|---|----------------|-----|---------------------------------|----------------------|----------------------|-----------------------|---------------------------------|
| 1/31/2001 | 4,052.67 | | | | | | 4,052.67 |
| 2/28/2001 | 4,052.67 | | | | | | 4,052.67 |
| 3/30/2001 | 4,052.67 | | | | | | 4,052.67 |
| 4/30/2001 | 4,052.67 | | | | | | 4,052.67 |
| 5/31/2001 | 4,052.67 | | | | 3,156.29 | | 7,208.96 |
| 6/29/2001 | 4,052.67 | | | | 2,021.23 | | 6,073.90 |
| 7/31/2001 | 4,052.67 | | | | | | 4,052.67 |
| 8/31/2001 | 4,052.67 | | | | | 1,581.00 | 5,633.67 |
| 9/28/2001 | 4,052.67 | | | | | | 4,052.67 |
| 10/30/2001 | 4,260.99 | (A) | | | 3,273.12 | | 7,534.11 |
| 11/30/2001 | 4,104.75 | | | | | 20.00 | 4,124.75 |
| 12/20/2001 | 4,104.75 | | | | 4,049.20 | | 8,153.95 |
| 2001 Totals | \$48,944.52 | | \$0.00 | \$0.00 | \$12,499.84 | \$1,601.00 | \$63,045.36 |
| 1/31/2002 | 4,104.75 | | | | 2,841.60 | | 6,946.35 |
| 2/28/2002 | 4,104.75 | | | | 2,738.48 | | 6,843.23 |
| 3/28/2002 | 4,104.75 | | 5,000.00 | | | | 9,104.75 |
| 4/30/2002 | 4,104.75 | | | | 1,833.72 | | 5,938.47 |
| 5/31/2002 | 4,104.75 | | | | 3,484.07 | | 7,588.82 |
| 6/28/2002 | 4,104.75 | | | | 825.17 | | 4,929.92 |
| 7/31/2002 | 4,104.75 | | | | 3,502.41 | | 7,607.16 |
| 8/30/2002 | 4,104.75 | | | | 2,768.92 | 1,601.00 | 8,474.67 |
| 9/30/2002 | 4,104.75 | | | | 5,684.53 | | 9,789.28 |
| 10/31/2002 | 4,104.75 | | | | 4,034.18 | | 8,138.93 |
| 11/27/2002 | 4,104.75 | | | | 2,750.58 | | 6,855.33 |
| 12/20/2002 | 4,104.75 | | | | 4,767.67 | | 8,872.42 |
| 2002 Totals | \$49,257.00 | | \$5,000.00 | \$0.00 | \$35,231.33 | \$1,601.00 | \$91,089.33 |
| 1/31/2003 | 4,104.75 | | 3,500.00 | | 5,134.42 | | 12,739.17 |
| 2/28/2003 | 4,104.75 | | | | 4,951.04 | | 9,055.79 |
| 3/31/2003 | 4,104.75 | | | | 825.17 | | 4,929.92 |
| 4/30/2003 | 4,104.75 | | | | 1,375.29 | | 5,480.04 |
| 5/30/2003 | 4,104.75 | | | | 3,025.64 | | 7,130.39 |
| 6/30/2003 | 4,104.75 | | | | 2,200.46 | | 6,305.21 |
| 7/31/2003 | 4,104.75 | | | | 916.86 | | 5,021.61 |
| 8/31/2003 | 4,104.75 | | | | 366.74 | 1,601.00 | 6,072.49 |
| 9/30/2003 | 4,583.33 | (B) | | | 2,585.55 | 149.00 | 7,317.88 |
| 10/31/2003 | 4,583.33 | | | 550.00 | | | 5,133.33 |
| 11/30/2003 | 4,583.33 | | | | | | 4,583.33 |
| 12/31/2003 | 4,583.33 | | | | | | 4,583.33 |
| 2003 Totals | \$51,171.32 | | \$3,500.00 | \$550.00 | \$21,381.17 | \$1,750.00 | \$78,352.49 |
| 1/31/2004 | 4,583.33 | | | | | | 4,583.33 |
| 2/28/2004 | 4,583.33 | | | | | | 4,583.33 |
| 3/31/2004 | 4,104.75 | (C) | | | | | 4,104.75 |
| 2004 (to date) | \$13,271.41 | | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$13,271.41 |
| Grand Total | \$162,644.25 | | \$8,500.00 | \$550.00 | \$69,112.34 | \$4,952.00 | \$245,758.59 |
| (A) \$625 Legislative Increase - retroactive to 7/1/2001 (\$52.08 per month). | | | | | | | |
| (B) Employee moved from a SPA position to an EPA position effective 9/1/2003. Annual salary increased from \$49,257 to \$55,000. | | | | | | | |
| (C) Employee moved from an EPA position back to a SPA position effective 3/1/2004. Annual salary decreased from \$55,000 to \$49,257. | | | | | | | |

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Personnel Assistant

| Payroll Period | Regular Salary | Overtime Payments | Payment for Bonus Leave | Legislative Bonus | Gross |
|---|--------------------|--------------------|-------------------------|-------------------|---------------------|
| 1/31/2001 | 2,432.00 | | | | 2,432.00 |
| 2/28/2001 | 2,432.00 | | | | 2,432.00 |
| 3/30/2001 | 2,432.00 | | | | 2,432.00 |
| 4/30/2001 | 2,432.00 | | | | 2,432.00 |
| 5/31/2001 | 2,432.00 | | | | 2,432.00 |
| 6/29/2001 | 2,432.00 | | | | 2,432.00 |
| 7/31/2001 | 2,432.00 | | | | 2,432.00 |
| 8/31/2001 | 2,432.00 | | | | 2,432.00 |
| 9/28/2001 | 2,432.00 | | | | 2,432.00 |
| 10/30/2001 | 2,640.32 (A) | | | | 2,640.32 |
| 11/30/2001 | 2,484.08 | | | | 2,484.08 |
| 12/20/2001 | 2,484.08 | 773.82 | | | 3,257.90 |
| 2001 Totals | \$29,496.48 | \$773.82 | \$0.00 | \$0.00 | \$30,270.30 |
| 1/31/2002 | 2,484.08 | | | | 2,484.08 |
| 2/28/2002 | 2,484.08 | | | | 2,484.08 |
| 3/28/2002 | 2,484.08 | 931.59 | | | 3,415.67 |
| 4/30/2002 | 2,484.08 | 372.51 | | | 2,856.59 |
| 5/31/2002 | 2,484.08 | | | | 2,484.08 |
| 6/28/2002 | 2,484.08 | | | | 2,484.08 |
| 7/31/2002 | 2,484.08 | | | | 2,484.08 |
| 8/30/2002 | 2,484.08 | | | | 2,484.08 |
| 9/30/2002 | 2,484.08 | 4,521.90 | | | 7,005.98 |
| 10/31/2002 | 2,484.08 | 1,719.60 | | | 4,203.68 |
| 11/27/2002 | 2,484.08 | 1,719.60 | | | 4,203.68 |
| 12/20/2002 | 2,484.08 | 1,999.04 | | | 4,483.12 |
| 2002 Totals | \$29,808.96 | \$11,264.24 | \$0.00 | \$0.00 | \$41,073.20 |
| 1/31/2003 | 2,484.08 | 537.38 | | | 3,021.46 |
| 2/28/2003 | 2,484.08 | 709.34 | | | 3,193.42 |
| 3/31/2003 | 2,484.08 | 483.64 | | | 2,967.72 |
| 4/30/2003 | 2,484.08 | | | | 2,484.08 |
| 5/30/2003 | 2,484.08 | | | | 2,484.08 |
| 6/30/2003 | 2,484.08 | | | | 2,484.08 |
| 7/31/2003 | 2,484.08 | | | | 2,484.08 |
| 8/31/2003 | 2,484.08 | | | | 2,484.08 |
| 9/30/2003 | 2,484.08 | | | | 2,484.08 |
| 10/31/2003 | 2,980.92 (B) | | | 550.00 | 3,530.92 |
| 11/30/2003 | 2,732.50 | | | | 2,732.50 |
| 12/31/2003 | 2,732.50 | | | | 2,732.50 |
| 2003 Totals | \$30,802.64 | \$1,730.36 | \$0.00 | \$550.00 | \$33,083.00 |
| 1/31/2004 | (C) | 1,973.62 | 2,521.60 | | 4,495.22 |
| 2004 (to date) | \$0.00 | \$1,973.62 | \$2,521.60 | \$0.00 | \$4,495.22 |
| Grand Totals | \$90,108.08 | \$15,742.04 | \$2,521.60 | \$550.00 | \$108,921.72 |
| (A) \$625 Legislative Increase - retroactive to 7/1/2001 (\$52.08 per month). | | | | | |
| (B) In-Range Adjustment - retroactive to 9/1/03 (\$248.42 per month) | | | | | |
| (C) Employee resigned 12/31/03, settlement payments for overtime/compensatory hours and bonus leave | | | | | |

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Special One-Time Special Payments to NCSA Employees

2002-2003 ONE-TIME SPECIAL PAYMENTS TO EPA EMPLOYEES (See Note C Below):

| EMPLOYEE POSITION | DIVISION or DEPARTMENT | ONE-TIME SPECIAL PAYMENT AMOUNT | PAYMENT DATE |
|--|--------------------------|---------------------------------|--------------|
| Special Assistant to Associate Director of Kenan Institute | TS Kenan Institute | 2,000.00 | 09/30/02 |
| Special Assistant to Associate Director of Kenan Institute | TS Kenan Institute | 1,685.60 | 12/20/02 |
| Associate VC for Special Projects | Finance & Administration | 3,000.00 | 04/30/03 |
| Controller | Finance & Administration | 3,000.00 | 04/30/03 |
| Associate VC for Information Tech./CIO | Information Technologies | 2,000.00 | 06/30/03 |
| Associate VC for Finance | Finance & Administration | 2,000.00 | 06/30/03 |
| Director of Facilities Management Plan | Finance & Administration | 3,000.00 | 06/30/03 |
| | Total | 16,685.60 | |

2002-2003 ONE-TIME SPECIAL PAYMENTS TO SPA EMPLOYEES SUBJECT TO THE FAIR LABOR STANDARDS ACT (See Note A Below):

| | | | |
|-------------------------------|---|------------------|----------|
| Personnel Analyst I* | Finance & Administration | 3,500.00 | 01/31/03 |
| Payroll Clerk** | Finance & Administration | 1,500.00 | 04/30/03 |
| Administrative Assistant I*** | Stevens Center | 1,500.00 | 05/30/03 |
| Office Assistant III*** | School of Drama | 2,400.00 | 05/30/03 |
| Sales Clerk II*** | Finance & Administration (Campus Bookstore) | 2,000.00 | 05/30/03 |
| | Total | 10,900.00 | |

NOTE: This one-time payment occurred in the 2001-2002 fiscal year:

| | | | |
|----------------------|--------------------------|----------|----------|
| Personnel Analyst I* | Finance & Administration | 5,000.00 | 03/28/02 |
|----------------------|--------------------------|----------|----------|

* Employee received significant overtime compensation during the period noted

** Employee received some nominal overtime compensation during the period noted

*** Employee did not receive any overtime compensation during the period noted

2002-2003 ONE-TIME SPECIAL PAYMENTS TO SPA EMPLOYEES NOT SUBJECT TO THE FAIR LABOR STANDARDS ACT (See Note B Below):

| | | | |
|--|---|------------------|----------|
| Administrative Secretary III | School of Drama | 3,059.42 | 07/31/02 |
| Information & Communication Specialist I | Public Relations | 2,500.00 | 09/30/02 |
| Student Center Technician | Fitness Center | 1,000.00 | 11/27/02 |
| Administrative Assistant II | TS Kenan Institute | 1,180.80 | 12/20/02 |
| Recreation Worker I | Fitness Center | 1,000.00 | 01/31/03 |
| Accountant I (Assistant Controller) | Finance & Administration | 3,000.00 | 04/30/03 |
| Executive Assistant I | Finance & Administration | 3,000.00 | 04/30/03 |
| Administrative Officer I | Stevens Center | 4,000.00 | 05/30/03 |
| Executive Assistant I | Office of the Provost (Arts & Academic Affairs) | 2,000.00 | 06/30/03 |
| | Total | 20,740.22 | |

Total of all One-Time Payments

53,325.82

Note A: A SPA employee subject to the FLSA must be paid a premium rate (time and one-half) in the form of monetary compensation or time off for hours worked in excess of 40 within a week

Note B: A SPA employee not subject to the FLSA earns compensatory leave on an hour for hour basis - employee can not be paid for this leave

Note C: An EPA employee does not earn compensatory leave or receive longevity payments

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Article 3H

Overpayments of State Funds

**§ 143-64.80. Overpayments of State funds to persons in
State-supported positions; recoupment required.**

**(a) An overpayment of State funds to any person in a
State-funded position, whether in the form of salary or
otherwise, shall be recouped by the entity that made the
overpayment and, to the extent allowed by law, the amount of the
overpayment may be offset against the net wages of the person
receiving the overpayment.**

**(b) No State department, agency, or institution, or other
State-funded entity may forgive repayment or an overpayment of
State funds, but shall have a duty to pursue the repayment of
State funds by all lawful means available, including the filing
Of a civil action in the General Court of Justice. (2003-263, s.1.)**

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TITLES/NAMES USED IN REPORT

| <u>Title</u> | <u>Name</u> | <u>Employment</u> |
|--|---------------------------|---------------------------|
| Chancellor | Wade Hobgood | 7/1/00 - Present |
| Vice Chancellor for Finance and Administration | Joe Dickson | 10/29/90 – 7/13/04 |
| Provost/Vice Chancellor for Arts and Academic Programs | Lucinda Lavelli | 8/1/02 - Present |
| Executive Assistant to the Vice Chancellor for Finance and Administration | Carol Phillips | 1/1/01 – Present |
| Dean of the School of Filmmaking | Dale Pollock | 1/1/99 – Present |
| Director of Human Resources | Mack Greer | 9/1/99 – 10/31/04 |
| Personnel Technician II | Berdette Malloy | 8/1/80 – Present |
| Personnel Officer II | Berdette Malloy | 8/1/80 – Present |
| Interim Human Resources Director | Berdette Malloy | 8/1/80 – Present |
| Assistant Director of Human Resources | Berdette Malloy | 8/1/80 – Present |
| Special Assistant to the Vice Chancellor | Berdette Malloy | 8/1/80 – Present |
| Personnel Analyst | Berdette Malloy | 8/1/80 – Present |
| Payroll Clerk | Debbie Gunter | 11/12/01 – Present |
| Assistant Controller | Calsine Pitt | 7/1/99 – 9/1/04 |
| Assistant Vice Chancellor for Special Projects | Constance Mallette | 5/1/98 – Present |
| Controller | Debbie Hodge | 8/22/84 – Present |
| Associate Vice Chancellor for Finance and Budget | Steve Mack | 7/1/89 – Present |
| Personnel Assistant | Cynthia Little | 6/1/98 – 1/3/04 |

Titles/Names Used in Report

| <u>Title</u> | <u>Name</u> | <u>Employment</u> |
|--|---------------------------|--------------------------|
| Associate Vice Chancellor for Information Technologies | Lisa Weatherman | 9/26/88 – Present |
| Director of Facilities Management Plan | Brent Lafever | 2/27/95 – Present |
| Special Assistant to the Associate Director of the Kenan Institute for the Arts | Jeanette Valentine | 8/1/92 - Present |
| Director of Budget (Foundation Controller) | Donna Sexton | 3/9/87 – Present |
| President of the Foundation's Board of Directors (Current) | Jeff Whittington | 7/1/03 - Present |

NORTH CAROLINA
SCHOOL OF THE ARTS

September 27, 2004

Mr. Ralph Campbell, Jr.
State Auditor
State of North Carolina
Office of the State Auditor
2 South Salisbury Street
Raleigh, NC 27699-0601

Re: Response from the North Carolina School of the Arts and the North Carolina School of the Arts Foundation, Inc.

Dear Mr. Campbell:

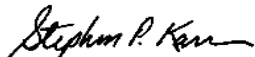
Thank you for your thorough, careful work and professionalism in connection with the Special Review of the North Carolina School of the Arts and the North Carolina School of the Arts Foundation, Inc. We appreciate your assistance in identifying and rectifying certain operational weaknesses. Both institutions are already stronger because of your efforts. We concur with your recommendations and have initiated corrective measures.

Enclosed please find our response to your report dated September 2004. The President of the Foundation Jeff Whittington joins in our response to Findings six through ten.

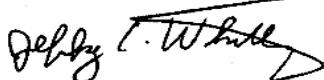
In the interest of providing accurate information to our campus community, once the Special Review has become public, we will be posting our response on the School's website www.ncarts.edu with a link to your website for the complete report.

Please contact me if you have any questions.

Sincerely,



Stephen P. Karr
Chairman
North Carolina School of the Arts Board of Trustees



Jeffrey C. Whittington
President
North Carolina School of the Arts Foundation, Inc.

cc: President Molly Corbett Broad
Chancellor Wade Hobgood

North Carolina School of the Arts
1533 South Main Street (27127), P.O. Box 12189, Winston-Salem, North Carolina 27117-2189

An equal opportunity constituent of the University of North Carolina

**RESPONSE TO SPECIAL REVIEW
NORTH CAROLINA SCHOOL OF THE ARTS
NORTH CAROLINA SCHOOL OF THE ARTS FOUNDATION, INC.
September 2004**

1. THE NORTH CAROLINA SCHOOL OF THE ARTS TWICE RECLASSIFIED A POSITION IN THE PERSONNEL DEPARTMENT WITHOUT THE APPROPRIATE APPROVAL OF THE UNIVERSITY OF NORTH CAROLINA OFFICE OF THE PRESIDENT AND THE OFFICE OF STATE PERSONNEL.

We recommend NCSA adhere to all relevant UNC and OSP personnel policies and procedures for appropriate designation of EPA positions. The Human Resources Director should contact the Office of State Personnel or the UNC Office of the President for guidance on procedures when questions arise. In addition, NCSA should expedite corrective action in a timely manner when directed by either OSP or the UNC Office of the President. We reiterate the position stated by UNC that if any other unauthorized EPA positions exist on campus, the School should take steps to return the positions to the appropriate designation. Also, we recommend UNC review the personnel actions for the Personnel Analyst and consult with the North Carolina Attorney General's Office concerning the process for requesting any possible salary repayments, as provided by G.S. 143-64.80.

NCSA Response:

We agree. In fact, as soon as the Chancellor was advised in the fall of 2003 of the possible improper classification of EPA employees, an internal review was initiated. Subsequently, NCSA has taken significant actions to strengthen the Human Resource operation and improve its policies, procedures and practices. The Chancellor ordered that Human Resources report directly to him rather than the Vice Chancellor of Finance and Administration, as had been the historic practice at the School. In addition, NCSA has hired the well-respected and recently retired Senior Director of Personnel Services from UNC Greensboro to serve as Interim Human Resources Director. With the assistance of the Office of the President and the Office of State Personnel, a thorough review of all other EPA reclassifications has been performed to determine their appropriateness and required approvals. Recommended adjustments are presently being implemented.

NCSA will work with the Office of the President in determining the specific amount of overpayment in compensation that resulted from any incorrect personnel actions. NCSA will also cooperate with the Office of the President and the Attorney General's Office in obtaining repayment of salary overpayments made to the Personnel Analyst, who is no longer employed by

NCSA. To further address these issues, NCSA will develop a general policy clearly stating that failure to comply with personnel policies of the Office of the President and the Office of State Personnel will result in disciplinary action up to and including dismissal.

- 2. FROM MAY 2001 THROUGH SEPTEMBER 2003, NCSA PAID THE PERSONNEL ANALYST \$69,112.34 FOR OVERTIME, WHICH APPEARS EXCESSIVE AND LACKS ADEQUATE SUPPORTING DOCUMENTATION. THIS AMOUNT INCLUDES \$22,753.21 IN INCORRECT CALCULATIONS FOR OVERTIME HOURS EARNED.**

We recommend NCSA ensure proper documentation is maintained to support overtime hours earned by its employees. Such documentation would include detailed and accurate timesheets, appropriate authorization and approval, and reason for overtime earned as well as reports/documents generated during the overtime hours worked. Supervisors should be aware of the amount and reason for overtime hours worked by subordinates. Overtime hours earned should be monitored to ensure hours claimed are actually worked. Timesheets should be attached to requests for overtime payments and be reviewed to ensure mathematical accuracy and proper tracking of overtime hours earned and paid. Special care should be taken to ensure that overtime earned at time and one-half is only computed at this rate one time to avoid overpayment. With regards to the existing overpayments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning the process for requesting reimbursement, as provided by G.S. 143-64.80.

NCSA Response:

We concur. NCSA has developed new policies and procedures for overtime pay and will provide additional training to supervisors. Consistent with existing requirements, this policy requires that an employee's timesheet be submitted to payroll along with the request for payment and evidence of prior approval, except in cases of emergency. This policy will be further revised to incorporate specific requirements including a statement from the supervisor describing the purpose of the overtime and the need for the overtime work, the retention of any documents and reports produced during the overtime work, and annual approval for those areas for which overtime pay is authorized in lieu of compensatory time. In addition, NCSA has conferred with Attorney General's Office concerning the process for obtaining repayment of overpayments and will appropriately pursue any overpayment.

3. FROM FEBRUARY 2001 THROUGH JANUARY 2004, THE SCHOOL OVERPAID A PERSONNEL ASSISTANT \$5,265.32 FOR INCORRECT OVERTIME CALCULATIONS.

We reiterate the need for NCSA to ensure proper documentation is maintained to support overtime hours earned by its employees. Such documentation would include detailed and accurate timesheets, appropriate authorization and approval, and reason for overtime earned as well as reports/documents generated during the overtime hours worked. Supervisors should be aware of the amount and reason for overtime hours worked by subordinates. Overtime hours earned should be monitored to ensure hours claimed are actually worked. Timesheets should be attached to requests for overtime payments and be reviewed to ensure mathematical accuracy and proper tracking of overtime hours earned and paid. Special care should be taken to ensure that overtime earned at time and one-half is only computed at this rate one time to avoid overpayment. With regards to the existing overpayments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning the process for requesting reimbursement, as provided by G.S. 143-64.80.

NCSA Response:

We concur. NCSA will appropriately pursue repayment of the \$5,265.32 overpayment to the Personnel Assistant following consultation with the Attorney General's Office. As noted above, NCSA has developed a new policy and procedure for authorizing, documenting and approving overtime that requires attachment of the timesheet.

4. NCSA INAPPROPRIATELY PAID 20 SPA AND EPA EMPLOYEES SPECIAL ONE-TIME PAYMENTS TOTALING \$53,325.

We recommend the School discontinue paying one-time payments to SPA employees who are ineligible to receive such compensation. SPA employees subject to the Fair Labor Standards Act should be compensated with time or money earned at the time and one-half rate for all hours worked over 40 during the week. SPA employees not subject to the Act should earn compensatory leave on an hour-for-hour basis for all time worked over 40 hours. OSP procedures should be followed in the cases where additional compensation is merited for dual employment, in-range adjustments and acting promotions. All overtime earned should be adequately documented on employee's timesheets and approved by supervisors. Supervisors should be aware of duties performed outside of employees' regular schedules to ensue accuracy in recording and the true need for hours earned.

We recommend the University of North Carolina develop a written policy addressing one-time special payments to EPA employees in order to ensure consistency among the 16 constituent institutions. If the University of North Carolina determines the payments are appropriate, the policy should require adequate documentation be submitted with payment requests and maintained to support the reason for and the accuracy of one-time payments.

With regard to the questionable one-time special payments, we recommend NCSA consult with the North Carolina Attorney General's Office concerning repayments by employees, as provided by G.S. 143-64.80.

NCSA Response:

We agree. Except when in accordance with OSP policies and procedures governing dual employment, in-range adjustments and acting promotions, NCSA has stopped paying one-time special payments to SPA employees. Furthermore, NCSA will pay additional compensation to EPA employees only in strict accordance with a newly developed campus policy, once it is reviewed and approved by the UNC Office of the President. NCSA has consulted with the Attorney General's Office regarding repayment by employees of any questionable one-time special payments that are ultimately determined to be overpayments. NCSA will comply with all additional policies that the Board of Governors may develop regarding additional compensation to EPA employees. NCSA will provide training to supervisors concerning these policies and the consequences for not complying.

5. THE PERSONNEL ANALYST APPROVED PERSONNEL ACTIONS, INCLUDING OVERTIME AND ONE-TIME PAYMENTS FOR HER SISTER.

We recommend no NCSA employees be involved in the authorization of payroll changes for immediate family members.

NCSA Response:

We agree. NCSA will ensure that appropriate internal controls are in place so that no employee is in the position to control the pay or other compensation for an immediate family member or to process related pay transactions.

6. EMPLOYEES APPEAR TO BE ABUSING THE EMPLOYEE LOAN PROGRAM BY TREATING THE FUNDS AS REVOLVING LINES OF CREDIT, EXCEEDING ALLOWED LOAN AMOUNTS AND FAILING TO REPAY LOANS WITHIN THE REQUIRED TIME LIMIT.

Management should enforce the loan fund guidelines regarding legitimate use of loan funds, timely repayment of loans and allowable loan amounts. Measures should be taken to ensure employees are not allowed to treat the emergency loan program as a revolving line of interest free credit.

NCSA and Foundation Response:

We concur. NCSA will work with the NCSA Foundation to develop more stringent policies and procedures to determine financial need and to ensure compliance with the loan fund guidelines. The Board of Directors of the NCSA Foundation, which holds the Loan Fund, will henceforth participate directly in reviewing loan applications and repayments. Outstanding loans that do not conform to the spirit of the present guidelines will be resolved as soon as possible.

7. STATE AND FOUNDATION FUNDS WERE USED TO IMPROPERLY FUND DISCRETIONARY ACCOUNTS NOT REPORTED TO THE FOUNDATION BOARD OF DIRECTORS.

We recommend someone independent of the Vice Chancellor for Finance and Administration be appointed to manage the operations of the Foundation. In addition, we recommend the Foundation consult with legal counsel regarding any possible reimbursement.

NCSA and Foundation Response:

We concur. Administrative management of the Foundation has been separated from the Vice Chancellor for Finance and Administration position and is now the responsibility of the Vice Chancellor for Advancement. Once the Vice Chancellor for Finance and Administration position is filled, NCSA will implement additional checks and balances to raise the level of integrity relative to financial operations and reporting. The NCSA Foundation Board has expanded its Finance Committee to include two new members with extensive financial accounting experience and will completely restructure its financial reporting system. Also, on July 13, 2004, the Executive Committee elected a new, more geographically accessible treasurer.

NCSA and the NCSA Foundation have agreed to a process that will restore restricted funds that were used for unrestricted purposes. In addition, the NCSA Foundation will perform a review of all expenditures from the discretionary accounts in question to determine, in consultation with legal counsel, any amounts that should be recovered from individuals and will appropriately pursue recovery of those amounts.

- 8. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION RECEIVED IN EXCESS OF \$90,000 OVER 13 YEARS FROM THE NCSA FOUNDATION, INC., IN VIOLATION OF THE UNIVERSITY OF NORTH CAROLINA POLICIES. IN ADDITION, THE FOUNDATION CONTROLLER MISLED AUDITORS CONCERNING THE PAYMENTS.**

We recommend the Foundation cease paying expense allowances, and instead reimburse NCSA employees directly for expenses incurred while conducting Foundation activities.

NCSA and Foundation Response:

We agree. The NCSA Foundation ceased paying the former Vice Chancellor for Finance and Administration an expense allowance for his services as Assistant Secretary/Treasurer of the Foundation, with the last payment being made in January 2004. No other such expense allowances exist. NCSA will re-communicate to Senior Academic and Administrative Officers, such as the vice chancellors, provosts and deans, the policies prohibiting compensation for any services rendered to any institution-related foundation, endowment or other University-related enterprise and the consequences for violating them. In addition, we will review the circumstances concerning the Controller's admission that she misled the auditors concerning the payments and will take appropriate personnel action.

- 9. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION TRANSFERRED THE TITLE TO REAL PROPERTY WITHOUT AUTHORIZATION RESULTING IN THE MISAPPLICATION OF \$108,000 FROM THE NORTH CAROLINA SCHOOL OF THE ARTS FOUNDATION, INC.**

The North Carolina School of the Arts Foundation should seek reimbursement for the \$108,000 deposited in the North Carolina School of the Arts Program Support Corporation's checking account.

NCSA and Foundation Response:

We concur. With respect to the proceeds from this real estate transaction, we have reached an agreement with the NCSA Foundation making it financially whole.

- 10. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION MISAPPLIED \$177,945 FROM THE NORTH CAROLINA SCHOOL OF THE ARTS FOUNDATION, INC., THROUGH THE TRANSFER OF OWNERSHIP AND SUBSEQUENT DISPOSITION OF REAL PROPERTY.**

The Foundation should seek reimbursement of \$177,945 from the NCSA Program Support Corporation.

NCSA and Foundation Response:

We concur. The NCSA Program Support Corporation has repaid the NCSA Foundation the total amount of the proceeds from this real estate transaction.

11. THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION AND THE DEAN OF THE SCHOOL OF FILMMAKING RECEIVED COMPENSATION FROM NCSA UNITY DEVELOPMENT CORPORATION IN VIOLATION OF UNIVERSITY OF NORTH CAROLINA REGULATIONS.

The North Carolina School of the Arts should develop and implement management controls to ensure compliance with regulations adopted by the Board of Governors of the University of North Carolina. In addition, the Office of the President of the University of North Carolina should firmly emphasize the importance of its regulations and the consequences of noncompliance.

NCSA Response:

While we accept and will carry out the recommendation, as the Special Report points out, NCSA had sought the advice and counsel of the Office of the President in evaluating the applicability of the UNC Board of Governor's policy to the Dean's proposed work on behalf of NCSA Unity Development Corporation, for which he has been fully compensated. A good-faith interpretation of the rules had also been applied in this instance to the Vice Chancellor for Finance and Administration, another employee within the classification of Senior Academic and Administrative Officers. NCSA will adhere to any and all interpretations, clarifications, or directives issued by the Office of the President concerning compensation for Senior Academic and Administrative Officers. NCSA will also develop and promulgate the additional management controls necessary to ensure compliance with policies adopted by the Board of Governors. In addition, NCSA will re-communicate to Senior Academic and Administrative Officers, such as vice chancellors, provosts and deans, the policies prohibiting compensation for any services rendered to any institution-related foundation, endowment or other University-related enterprise and the consequences for failing to follow them.

RESPONSE FROM THE UNIVERSITY OF NORTH CAROLINA



The University of North Carolina

OFFICE OF THE PRESIDENT

POST OFFICE BOX 2688, CHAPEL HILL, NC 27515-2688

MOLLY CORBETT BROAD, *President*

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University

East Carolina
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Technical State
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the Arts

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at Raleigh

University of
North Carolina
at Asheville

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North Carolina
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at Pembroke

University of
North Carolina
at Wilmington

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University

Winston-Salem
State University

An Equal Opportunity/
Affirmative Action
Employer

September 27, 2004

Mr. Ralph Campbell, Jr.
North Carolina State Auditor
Office of the State Auditor
2 South Salisbury Street
Raleigh, North Carolina 27699-0601

Dear Mr. Campbell:

RE: Response to the Special Review of the North Carolina School of the Arts

Enclosed you will find the response of the UNC Office of the President to the special review your office recently completed at the North Carolina School of the Arts. As requested, the response outlines actions taken or planned by this office in light of the review team's findings and recommendations. We appreciate the thoroughness and professionalism your staff exhibited throughout this process and will move quickly to implement all proposed steps. If you have questions or need further clarification, please do not hesitate to contact me.

Sincerely,

Molly Corbett Broad

Enclosure

cc: Chairman Stephen P. Karr
President Jeff Whittington
Chancellor Wade Hobgood

Response of the UNC Office of the President to the Special Review of the North Carolina School of the Arts by the Office of the State Auditor

All senior officers of the University of North Carolina are expected to perform their responsibilities professionally and ethically. Thus, the Auditor's findings in this special review that indicate certain officers of the North Carolina School of the Arts deliberately circumvented established University policies and procedures and intentionally misled members of the NCSA Foundation Board of Directors are deeply troubling. Particularly troubling are findings that implicate the School's chief financial officer, an individual entrusted to set the standard for adhering to policies and procedures and providing information about transactions in a forthright manner.

Findings presented by the Auditor reveal that on multiple occasions, clear guidance from the UNC Office of the President and policies of the UNC Board of Governors were ignored, and decisions were made that directly conflicted with known policies and directives. When the School's Chancellor was made aware of the situations described in this review, he acted decisively and with the full support of the Office of the President in accepting the resignations of two key individuals and in later accepting the resignation of a third employee. In taking prompt action, the Chancellor acted in the best interests of the institution. The Office of the President will continue to provide legal and financial services support to the Chancellor until all cited issues are fully resolved.

We acknowledge that designation as a special responsibility constituent institution is a critically important management tool for our campuses that comes with an inherent responsibility to exercise the highest levels of fiscal accountability and professional judgment. Errors in judgment clearly have occurred at the NC School of the Arts in this instance. Consistent with statutory requirements, the Chancellor will be notified immediately that the School has 90 days to show satisfactory progress in resolving all special review findings or the President will recommend to the Board of Governors that budget flexibility for the institution be withdrawn.

In addition to recommending that the School's budget flexibility be "carefully and fully reviewed," the Auditor makes several other recommendations concerning general University operations for consideration by the Office of the President. Responses to those specific recommendations are listed below.

- On page 20, the Auditor recommends that "UNC review the personnel actions for the Personnel Analyst and consult with the North Carolina Attorney General's Office concerning the process for requesting any possible salary repayments." Consistent with other recommendations in the special review, the Office of the President will work with responsible individuals at the School of the Arts to carry out the Auditor's recommendation.
- On page 31, the Auditor recommends that the University "develop a written policy addressing one-time special payments to EPA employees in order to ensure consistency among the 16 constituent institutions." We concur with this recommendation and will recommend that the Board of Governors adopt a policy that specifies when one-time payments are appropriate, who must approve the expenditure(s), and what documentation is required.
- On page 56, the Auditor recommends, with respect to the Board of Governors' prohibition of Senior Officers receiving supplemental pay from UNC foundations and other related entities, that "the Office of the President of the University of North Carolina should firmly emphasize the importance of its regulations and the consequences of noncompliance." The Office of the President does not agree with the Auditor's conclusion that the Unity Development Corporation is an entity that was intended to come within the meaning of this policy. Nonetheless, in light of this ambiguity, the President will recommend that the Board of Governors clarify its policy, and she will reiterate to the Chancellors and all Senior Officers of the University the importance of following Board policies and regulations and remind them that noncompliance can result in dismissal.

- On page 58, the Auditor recommends that “the President of the University and the Board of Governors review its policies regarding foundations and related organizations associated with constituent institutions in the University of North Carolina system. More specifically we recommend the University of North Carolina and the Board of Governors require each institution to identify all foundations and related organizations and provide the University of North Carolina with a report of their activities including revenue and expenditures.” As cited in the special review, the Board of Governors in 1990 established a requirement that foundations be audited annually and that a copy of the audits be provided to the Office of the President. In 1997, the Board of Governors approved a subsequent resolution directing the President to require that foundations establish organizational standards and implement appropriate financial controls. The Program Support Foundation described in the special review should have met the Board’s standards, but did not. While this foundation was formed after annual audit and reporting requirements were instituted, the Office of the President had no knowledge of its existence. The President will immediately survey each chancellor to determine whether other such foundations exist. In addition, with respect to the annual certifications that must be signed by the chancellors to comply with reporting requirements under budget flexibility, the President will hereafter require that the chancellors list all affiliated foundations and entities, affirm that they have adequate financial controls in place, and attest that no other affiliated foundations or entities exist.

September 27, 2004

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

EXECUTIVE BRANCH

The Honorable Michael F. Easley
The Honorable Beverly M. Perdue
The Honorable Richard H. Moore
The Honorable Roy A. Cooper, III
Mr. David T. McCoy
Mr. Robert L. Powell

Governor of North Carolina
Lieutenant Governor of North Carolina
State Treasurer
Attorney General
State Budget Officer
State Controller

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Mr. James D. Johnson

Senate President Pro Tem
Speaker of the NC House of Representatives
Speaker of the NC House of Representatives
NC House and Senate
Director, Fiscal Research Division

OTHER PARTIES

Mrs. Molly Corbett Board
Mr. Stephen P. Karr

Mr. Jeff Whittington

Ms. Robin Pendergraft
Mr. Thomas J. Keith

President, University of North Carolina
Chairman, North Carolina School of the Arts
Board of Trustees
President, North Carolina School of the Arts
Foundation, Inc., Board of Directors.
Director, North Carolina State Bureau of Investigation
District Attorney for the 21st Prosecutorial District

October 5, 2004

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

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Telephone: 919/807-7500

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