UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee

September 24, 2019

University of North Carolina School of the Arts
Kilpatrick Townsend & Stockton, LLP
1001 West Fourth Street
Winston-Salem, NC 27101

COMMITTEE MEMBERS:
Stephen Berlin, Chair
Pete Brunstetter
Anna Folwell
Rob King
Ralph Womble, ex officio

COMMITTEE STAFF:
Shannon B. Henry, Chief Audit, Risk, and Compliance Officer
David Harrison, Vice Chancellor for Institutional Integrity and General Counsel
Jim DeCristo, Vice Chancellor for Economic Development and Chief of Staff
Michael Smith, Vice Chancellor for Finance and Administration
Amanda Balwah, Secretary of the University
Martha Golden, Faculty Council Representative
Sharon Fogarty, Staff Council Representative

AGENDA

OPEN SESSION

1. Call to Order and Confirm Quorum ..... .Chairman Berlin
2. Approval of Minutes from the April 23, 2019 Meeting.....Chairman Berlin
3. Matters of Governance, Risk and Compliance……Shannon Henry
    a. Enterprise Risk Management..... ……Jim DeCristo, Vice Chancellor for Economic Development and Chief of Staff
    b. Information Governance and Security ..... Greg Gleghorn, Director of Information Security
    c. Title IX and Clery Compliance……..Valerie Thelen, Chief Compliance Officer & Director of Title IX
    d. University Ombudsman……Dr. Joshua Canzona
4. Discussion of External Audits & Reviews (if any) ..... ……Shannon Henry

a. UNCSA Annual Financial Statement Audits…….Lisa McClinton, Associate Vice Chancellor for Finance

b. UNCSA Foundation, Inc. Financial Statement Audit……Cindy Liberty, Executive Director

Note: Information related to any external audits or reviews released prior to the meeting will be provided at the meeting.

5. Discussion of Internal Audit's Reports, Open Projects, and Plans…….Shannon Henry and Rod Isom, Internal Audit Manager

   a. Activity Summaries and Reports*

   b. Annual Risk Assessment and Updated Internal Audit Plan*

   c. Other Business*

   d. Review of Committee and Office Charters*

**Additional information related to this item or any internal audits or reviews released prior to the meeting will be provided at the meeting.*

CLOSED SESSION

6. Approval of Minutes from the April 23, 2019 Meeting..... Chairman Berlin
7. Discussion of Special Items, Reviews and Investigations *(if any)* ……Shannon Henry & David Harrison

OPEN SESSION

8. Other Business… .....Committee Members & Staff
9. Adjourn… ..... Chairman Berlin

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee

DRAFT OPEN MINUTES

April 23, 2019
University of North Carolina School of the Arts
Law Office of Kilpatrick Townsend & Stockton LLP
Winston-Salem, North Carolina

TRUSTEES PRESENT

Steve Berlin (Chair)*, Anna Folwell (phone)*, Rob King*,

*denotes voting member

TRUSTEE ABSENT

Pete Brunstetter*, Ralph Womble (ex officio)*

COMMITTEE STAFF PRESENT

Shannon Henry (Chief Audit, Risk, and Compliance Officer), David Harrison (General Counsel), Jim DeCristo (Chief of Staff), Michael Smith (VC for Finance and Administration), Sharon Fogarty (Staff Counsel Representative)

OTHERS PRESENT

Lisa McClinton (Associate Vice Chancellor for Finance and Controller), Austin Grier (Risk and Compliance Program Specialist)

CONVENE MEETING AND CONFIRM QUORUM

Committee Chair Steve Berlin convened the Open Session of the University of North Carolina School of the Arts' Audit, Risk, and Compliance Committee at 4:05 p.m. A quorum was confirmed.

APPROVAL OF MINUTES

MOTION: Rob King moved to approve the minutes from the February 5, 2019 meeting. Anna Folwell seconded and the minutes were unanimously approved.

ENTERPRISE RISK MANAGEMENT (ERM) AND COMPLIANCE

Jim DeCristo, Chief of Staff, reported that during FY19, the ERM Steering Committee and Risk Owners focused on the following five strategic risks as priorities for the academic year:

1. UNCSA may struggle to attract and retain the faculty talent needed to support excellence in its offerings.

2. A potential decline in financial and other incentives to attend UNCSA may make it more difficult to effectively attract qualified students.

3. The condition of facilities and residence halls may decline to the point that it significantly deters students from attending UNCSA.
4. The School may have difficulty attracting diverse faculty, students, and staff to advance its brand and reputation.
5. UNCSA may have difficulty achieving the right balance of rigor, intimacy, transparency, and diversity necessary to maintain a balanced campus culture that promotes excellence, open-mindedness, and well-being alike.

These risks were captured and detailed in an ERM report. This year was management's first full year of ERM activities and management feels this year has been successful. There are opportunities to develop Key Risk Indicators (KRIs) that will enable management to better track progress with regard to mitigating activities and better predict and prevent risk events from occurring. Immediate next steps include facilitating a Bowtie Risk Analysis which examines opportunities to prevent risk events from occurring, and opportunities to react should risk events occur.

MATTERS OF GOVERNANCE AND COMPLIANCE

A. Information Security Update

Michael Smith, VC for Finance and Administration gave the following information governance and security update, on behalf of Greg Gleghorn, Director of Information Security:

- Seven new information security regulations have been submitted for legal and chancellor approval.
- Sixteen out of seventeen scheduled business impact analysis interviews have been completed.
- Centralized endpoint protection project 60% complete.
- Phishing and impersonation attempts have been reduced with constant monitoring, tweaking, and optimizing of Microsoft's advanced threat protection.

B. Director of Human Services – Posting Update

Lisa McClinton, Associate Vice Chancellor for Finance and Controller, gave the following posting update concerning the Director of Human Services:

On campus interviews were conducted with eight candidates, and two finalists were identified. The committee has submitted a recommendation to Michael Smith who anticipates an offer will be made soon.

INTERNAL AUDIT UPDATE

Summary of New Reports

- The follow-up report concerning deficiencies as it relates to contracting with vendors is in the draft phase. Two of the three findings have been resolved and management has identified compensating controls associated with lingering risks. Once evidence

of these controls has been reviewed and documented, the follow-up report will be released.

NEXT PLANNED REVIEW

- A review of Environmental Health and Safety has begun. The review will focus on Life Safety protocols with an emphasis on the quantity and quality of these protocols and related activities, and other matters of compliance. The review will include a campus-wide survey of faculty and staff that will serve as a micro engagement level risk assessment to identify potential risk exposures.

CLOSED SESSION

MOTION: Rob King moved to go into closed session to prevent the disclosure of privileged Internal Auditor's work papers, under Section 116-40.7 of the North Carolina General Statutes. Anna Folwell seconded and the motion was unanimously approved.

ADJOURNMENT

After returning to Open Session, there was no further business to discuss. Chairman Berlin adjourned the meeting at 4:59 p.m.

Respectfully submitted by:
Austin Grier
Risk and Compliance Program Specialist

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

Enterprise Risk Management (ERM) Report…….presented by Jim DeCristo, Chief of Staff

Summary: Throughout the 2019-2020 academic year, UNCSA's ERM Initiative will delve deeper into the strategic work of examining the causes, responses to prevent risk, consequences, and responses to minimize impact for each of the identified risk priorities. To do this, the bow-tie analysis tool will be utilized to help identify key risk indicators that could provide an early warning of impending risk events. Each risk owner will be provided with a template to make this next level of strategic analysis effective and efficient.

The ERM team is in the process of meeting with new leadership to bring them up to speed on UNCSA's risk priorities. Regular meetings with each risk owner and their teams will happen throughout the academic year. Quarterly meetings for the ERM Steering Committee have already been scheduled to review the progress made via the bow-tie analyses.

Action: This report is for informational purposes only.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

Information Security Update…….*presented by Greg Gleghorn, Director of Information Security*

Summary:

1. Our Internal Risk Assessment score improved from the previous year's score of 1.37 to 1.54. We still fell short of our goal of 2.0 for 2019, but our trend is on a positive incline.

2. We have installed an email security gateway that has addressed one of our major vulnerabilities, threats, and attack vectors, and that is phishing. We installed the email security gateway in April of 2019, and since then our phishing attacks have been reduced by well over half. As the gateway learns our email patterns, the more effective and efficient it becomes.

3. We have successfully tested email encryption and data loss prevention. Encryption and data loss prevention complement the email security gateway in that any personally identifiable information, SSN, credit card, health information, etc., sent outside of the organization unencrypted will receive a friendly reminder to encrypt this type of data before sending.

4. We have also installed Network Admission Control, which is currently running in audit mode. The NAC allows us to profile all devices connected and connecting to our campus infrastructure whether it is wired or wireless. We are currently profiling all of our connected devices (wired and wireless). This process will give us specific knowledge in determining if a device is a friend, foe, guest, contractor, etc. This, in turn, helps us with incident response and management, service requests, access, authorization, and accounting.

Action: This agenda item is for informational purposes only.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

Title IX Office and Clery Compliance Update…….presented by Valerie Thelen, Chief Compliance Officer and Director of Title IX

Summary:

Training for students: During orientation week students attended a 1 hour educational performance on sexual assault prevention, consent, and bystander intervention.

Attendance: 780 undergraduate/graduate students, 230 high school students (11th and 12th grades), total 1,010.

Prior to this, students had limited or no training on these topics.

This is part of an overall Title IX related training and education program to increase student knowledge in order to prevent and address sexual misconduct on campus.

Training for staff: ongoing training by department

Departments trained: Drama, Dance, High School faculty, Residence Life and Housing (Summer and Fall staff), new Undergraduate faculty, new staff during Human Resources on-boarding

This is part of an overall Title IX related training and education program for staff and faculty to increase knowledge and understand their responsibility for reporting, specifically targeted for those with the most interaction with students.

The annual report for Clery Compliance, the Annual Security Report (ASR), is due October 1st.

Action: This report is for informational purposes only.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

University Ombudsman…….presented by Dr. Joshua Canzona

Summary: Joshua Canzona will summarize his work as University Ombuds over the last two years and discuss some campus trends:

- Brief description of the ombuds role: allowing faculty and staff a chance to be heard, a resource for informal conflict resolution, and as a means to identify pressure points within the institution
- Institutional benefits of an ombuds program
- Success in setting up a program at UNCSA
- Visitor totals and demographics for AY 2017-18 and 2018-19
- Prevalent issues or themes emerging during ombuds visits

Action: Informational Purposes Only

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

Financial Statement Audits Updates……Lisa McClinton, Associate Vice Chancellor for Finance

Summary: NC Office of the State Auditor is conducting the University's financial statement audit for FY2019. Bernard Robinson & Company, LLP firm is conducting the FY 2019 audits for the UNCSA Housing Corporation and UNCSA Program Support Corporation.

- UNCSA Housing Corporation and UNCSA Program Support Financial Statement Audit 2019 - Housing Corp. is underway with a completion date by October.

- UNCSA Financial Statement Audit for Fiscal Year 2019 has been delayed due to a change to the audit team. They plan to arrive on campus late September to begin their fieldwork. We still hope the audit will be released before December's board meeting.

Action: This item is for informational purposes only.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Financial Statements

Years Ended June 30, 2019 and 2018

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Financial Statements

Years Ended June 30, 2019 and 2018

University of North Carolina School of the Arts Foundation, Inc.

Contents

SMITH LEONARD
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Independent Auditor's Report

Board of Directors
University of North Carolina School of the Arts Foundation, Inc.
Winston-Salem, North Carolina

We have audited the accompanying consolidated financial statements of University of North Carolina School of the Arts Foundation, Inc. (a nonprofit organization) and its subsidiary, which comprise the consolidated statements of financial position as of June 30, 2019 and 2018, and the related consolidated statements of activities, functional expenses and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of University of North Carolina School of the Arts Foundation, Inc. and its subsidiary as of June 30, 2019 and 2018, and the changes in their net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Smith Leonard PLLC

High Point, North Carolina
August 30, 2019

Smith Leonard PLLC, Accountants & Consultants ■ 4035 Premier Drive, Suite 300, High Point, NC 27265-8311 ■ Phone: 336.883.0181 ■ Fax: 336.841.8764

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statements of Financial Position
June 30, 2019 and 2018

	2019	2018
Assets		
Cash and cash equivalents	**$ 14,927,439**	$ 9,878,614
Investments	**52,036,280**	44,778,524
Annuity investments	**11,100**	13,685
Prepaid expenses and other current assets	**52,202**	53,788
Assets to be transferred to UNCSA	**121,348**	56,222
Pledges receivable, net	**8,987,651**	8,776,897
Beneficial interest in perpetual trusts	**751,062**	790,400
Property	**60,001**	60,001
Other assets	**14,558**	67,896
Total assets	**$ 76,961,641**	$ 64,476,027
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	**$ 90,113**	$ 27,916
Annuity obligations	**18,164**	24,121
Due to UNCSA	**196,267**	734,056
Total liabilities	**304,544**	786,093
Commitments and contingencies		
Net assets		
Without donor restrictions:		
Unappropriated	**1,950,985**	726,774
Board appropriated	**247,450**	91,731
With donor restrictions	**74,458,662**	62,871,429
Total net assets	**76,657,097**	63,689,934
Total liabilities and net assets	**$ 76,961,641**	$ 64,476,027

See accompanying notes to consolidated financial statements.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statement of Activities
Year Ended June 30, 2019

	Without Donor Restrictions	With Donor Restrictions	Total
Revenue and support			
Gifts and grants	$ 1,817,744	$ 12,946,730	$ 14,764,474
Interest and dividend income	204,872	17,011	221,883
Change in fair value of:			
Annuity investments	-	489	489
Perpetual trusts	-	(39,338)	(39,338)
Annuity obligations	-	2,883	2,883
Other assets	-	(53,338)	(53,338)
Net gain (loss) on other investments reported at fair value, net of fees	(239,575)	3,798,832	3,559,257
Other income	25,953	207,046	232,999
Net assets released from restrictions	5,110,568	(5,110,568)	-
Total revenue and support	6,919,562	11,769,747	18,689,309
Expenditures			
Program services:			
Scholarships and awards	2,037,934	-	2,037,934
School programs	2,445,736	-	2,445,736
Advancement costs	470,742	-	470,742
Total program services	4,954,412	-	4,954,412
Support services:			
Administrative costs	585,220	-	585,220
Total expenditures	5,539,632	-	5,539,632
Change in net assets before transfers	1,379,930	11,769,747	13,149,677
Transfers to UNCSA	-	(182,514)	(182,514)
Change in net assets	1,379,930	11,587,233	12,967,163
Net assets, beginning of year	818,505	62,871,429	63,689,934
Net assets, end of year	$ 2,198,435	$ 74,458,662	$ 76,657,097

See accompanying notes to consolidated financial statements.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statement of Activities
Year Ended June 30, 2018

	Without Donor Restrictions	With Donor Restrictions	Total
Revenue and support			
Gifts and grants	$ 557,604	$ 9,945,597	$ 10,503,201
Interest and dividend income	91,808	10,735	102,543
Change in fair value of:			
Annuity investments	-	25,670	25,670
Perpetual trusts	-	29,441	29,441
Annuity obligations	-	(1,681)	(1,681)
Other assets	-	(10,000)	(10,000)
Net gain on other investments reported at fair value, net of fees	(209,413)	4,804,092	4,594,679
Other income	29,043	249,828	278,871
Net assets released from restrictions	5,626,216	(5,626,216)	-
Total revenue and support	6,095,258	9,427,466	15,522,724
Expenditures			
Program services:			
Scholarships and awards	2,000,714	-	2,000,714
School programs	1,819,843	-	1,819,843
TSKIA programs	1,141,952	-	1,141,952
Advancement costs	473,409	-	473,409
Total program services	5,435,918	-	5,435,918
Support services:			
Administrative costs	549,394	-	549,394
Total expenditures	5,985,312	-	5,985,312
Change in net assets before transfers	109,946	9,427,466	9,537,412
Transfer of TSKIA funds	-	(654,726)	(654,726)
Transfers to UNCSA	-	(56,222)	(56,222)
Change in net assets	109,946	8,716,518	8,826,464
Net assets, beginning of year	708,559	54,154,911	54,863,470
Net assets, end of year	$ 818,505	$ 62,871,429	$ 63,689,934

See accompanying notes to consolidated financial statements.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statement of Functional Expenses
Year Ended June 30, 2019

	Program Services			Support Services	
	Scholarships and Awards	School Programs	Advancement Costs	Administrative Costs	Total
Scholarships and awards	$ 2,037,934	$ -	$ -	$ -	**$ 2,037,934**
Salaries and benefits	-	584,978	67,992	405,453	**1,058,423**
Support of school performances	-	1,000,622	-	-	**1,000,622**
Office supplies, services and administrative expenses	-	282,614	377,432	67,808	**727,854**
Conferences, meetings, travel and entertainment	-	435,460	17,675	3,259	**456,394**
Educational supplies	-	96,064	-	-	**96,064**
Occupancy costs	-	-	-	82,958	**82,958**
Other	-	45,998	7,643	25,742	**79,383**
Total functional expenses	$ 2,037,934	$ 2,445,736	$ 470,742	$ 585,220	**$ 5,539,632**

Advancement costs are classified as program services as these represent support of the School's Department of Advancement

See accompanying notes to consolidated financial statements.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statement of Functional Expenses
Year Ended June 30, 2018

	Program Services				Support Services	
	Scholarships and Awards	School Programs	TSKIA Programs	Advancement Costs	Administrative Costs	Total
Scholarships and awards	$ 2,000,714	$ -	$ 216,555	$ -	$ -	$ 2,217,269
Salaries and benefits	-	374,258	454,922	81,992	440,742	1,351,914
Support of school performances	-	603,565	296,249	-	-	899,814
Office supplies, services and administrative expenses	-	184,710	73,343	366,673	78,491	703,217
Conferences, meetings, travel and entertainment	-	454,137	82,709	17,962	9,084	563,892
Educational supplies	-	196,840	6,956	-	-	203,796
Other	-	6,333	11,218	6,782	21,077	45,410
Total functional expenses	$ 2,000,714	$ 1,819,843	$ 1,141,952	$ 473,409	$ 549,394	$ 5,985,312

Advancement costs are classified as program services as these represent support of the School's Department of Advancement

See accompanying notes to consolidated financial statements.

University of North Carolina School of the Arts Foundation, Inc.

Consolidated Statements of Cash Flows
Years Ended June 30, 2019 and 2018

	2019	2018
Operating activities		
Change in net assets	**$ 12,967,163**	$ 8,826,464
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Write-off of pledges receivable	**11,000**	47,743
Net gain on investments reported at fair value	**(3,798,747)**	(4,832,677)
Changes in fair value of:		
Perpetual trusts	**39,338**	(29,441)
Annuity obligations	**(2,883)**	1,681
Other assets	**53,338**	10,000
Change in operating assets and liabilities:		
Prepaid expenses and other current assets	**(63,540)**	45,310
Pledges receivable, net	**(221,754)**	(1,032,943)
Accounts payable and accrued expenses	**62,197**	6,368
Due to UNCSA	**(537,789)**	(5,637,094)
Net cash provided by (used in) operating activities	**8,508,323**	(2,594,589)
Investing activities		
Purchase of investments, net	**(3,459,498)**	(3,308,327)
Transfer from annuity investments	**-**	394,870
Net cash used in investing activities	**(3,459,498)**	(2,913,457)
Change in cash and cash equivalents	**5,048,825**	(5,508,046)
Cash and cash equivalents, beginning of year	**9,878,614**	15,386,660
Cash and cash equivalents, end of year	**$ 14,927,439**	$ 9,878,614

See accompanying notes to consolidated financial statements.

1. Organization and Principles of Consolidation

University of North Carolina School of the Arts Foundation, Inc. (the "Foundation") is a not-for-profit organization founded in 1964 for the purpose of fostering and promoting the growth, progress and general welfare of the University of North Carolina School of the Arts (the "School" or "UNCSA"). The Foundation is a component unit of the School and is discretely presented in the consolidated financial statements of the School. UNCSA Foundation Management, LLC ("UNCSAFM") is a wholly owned subsidiary and is a vehicle for acquiring real estate and other investments of the Foundation. The consolidated financial statements include the accounts of UNCSAFM from its inception. All significant inter-entity transactions have been eliminated.

2. Summary of Significant Accounting Policies

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation and changes therein are classified and reported as follows:

- Without donor restrictions – net assets that are not subject to donor-imposed stipulations.
- With donor restrictions – net assets subject to donor-imposed stipulations that may or will be met either by actions of the Foundation and/or passage of time, as well as those that may be maintained permanently by the Foundation. Generally, the donors of these assets permit the Foundation to use all of or part of the income (which includes realized and unrealized gains on investments) earned on related investments for general or specified purposes.

Gains and losses on permanent endowment funds are reported as increases or decreases within net assets with donor restrictions as endowment returns subject to future appropriation.

Revenues are reported as increases in net assets without donor restrictions unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in net assets without donor restrictions. Expirations of net assets with donor restrictions (i.e., the donor-imposed stipulation has been fulfilled and/or the stipulation time period has elapsed) are reported as net assets released from restrictions on the consolidated statement of activities.

During 2019, the Foundation adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance and cash flows. Main provisions of this guidance include: Presentation of two classes of net assets versus the previously required three and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also enhances disclosures for board designated amounts, composition of net assets without donor restrictions, liquidity and expenses by both their natural and functional classification.

2. Summary of Significant Accounting Policies (Continued)

A recap of the net asset reclassifications as of June 30, 2018 related to the adoption of ASU 2016-14 follows:

	ASU 2016-14 Classifications		
Net Asset Classifications	**Without Donor Restrictions**	**With Donor Restrictions**	**Total Net Assets**
As previously presented:			
Unrestricted	$ 817,931	$ -	$ 817,931
Temporarily restricted	-	21,595,377	21,595,377
Permanently restricted	-	41,276,626	41,276,626
Net assets, as previously presented	817,931	62,872,003	63,689,934
Reclassifications to implement ASU 2016-14:			
Underwater endowments	574	(574)	-
Net assets, as reclassified	$ 818,505	$ 62,871,429	$ 63,689,934

Use of Estimates

The preparation of consolidated financial statements in accordance with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contributions and Revenue Recognition

The Foundation recognizes contributions, including unconditional promises to give, as revenue in the period received. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions to be received after one year are discounted at a risk-adjusted market rate determined at the date of the gift. As of June 30, 2019 and 2018, the rate used was 4.5%. Amortization of the discount is recorded as additional contribution revenue. Allowance is made for uncollectible contributions receivable based upon an analysis of past collection experience and other relevant factors.

Two donors accounted for 57% of gross pledges receivable at June 30, 2019. Four donors accounted for 85% of gross pledges receivable at June 30, 2018. Two donors accounted for 54% of gifts and grants in 2019 and three donors accounted for 55% of gifts and grants in 2018.

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities (Topic 958) Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*, which will assist entities in evaluating whether transactions should be accounted for as contributions or as exchange transactions and determining whether a contribution is conditional. This ASU was adopted during 2019 without impact on these consolidated financial statements.

2. Summary of Significant Accounting Policies (Continued)

The ability of the Foundation's contributors to continue giving amounts comparable with prior years is dependent, amongst other factors, upon current and future economic conditions and the continued deductibility for income tax purposes of contributions to the Foundation. While the Foundation's Board of Directors ("Board") believes the Foundation has the resources to continue to support the School's programs, its ability to do so and the extent to which it continues, may be dependent on the above factors.

Except as discussed in Note 10, no amounts have been reflected in the consolidated financial statements for donated services as the Foundation generally pays for specific expertise. Individuals volunteer their time and perform a variety of tasks that assist the Foundation, but these services do not meet the criteria for recognition as contributed services.

Investments

The Foundation's endowment investments are managed within the UNC Investment Fund ("UNCIF"), a pooled investment fund vehicle for constituent institutions of the University of North Carolina System. Securities and other assets of UNCIF are primarily held by an independent custodian. UNCIF is designed to provide long-term, stable rates of return on the invested assets through the use of a diversified portfolio strategy. The investment objective is to earn an average real total return of at least 5.5% per year, net of fees, over rolling five and 10-year periods. Investments held in alternative structures are reported at fair value based on estimates provided by UNCIF. Interest and dividend income is recorded when earned.

Investments are made by investment managers engaged by the Foundation and are monitored by the Foundation's finance committee. UNCIF's investments may be held in a variety of investment forms. Investment securities and other investments, including alternative investments in general, are exposed to various risks, such as interest rate risk, credit risk, liquidity risk, foreign currency risk and overall market volatility. Although the market value of investments is subject to fluctuations, management believes the investment policy is prudent for the long-term welfare of the Foundation. UNCIF limits the amounts that can be withdrawn for spending distributions as well as capital withdrawals.

Endowments

The executive committee of the Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanent endowment funds (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

2. Summary of Significant Accounting Policies (Continued)

The remaining portion of the permanent endowment fund that does not have donor restrictions is held until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) The duration and preservation of the various funds, (2) the purposes of the donor-restricted endowment funds, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return from income and the appreciation of investments, (6) other resources of the Foundation, and (7) the Foundation's investment policies.

In accordance with UPMIFA, if an institution determines a restriction on funds is impracticable, the institution may release or modify the restriction if the fund has a total value of less than $100,000, more than 10 years have elapsed since the fund was established and the institution uses the property in a manner consistent with the charitable purposes expressed in the gift instrument. This process is subject to the oversight of the Attorney General of North Carolina.

Endowment Distribution Policy

Endowment funds are accounted for using a unitized investment pool, with each endowment being assigned units in the pool. The per unit distribution is adjusted by the change in the All Urban Consumer Price Index. Annual distributions are limited (subject to donor stipulations) to a maximum of 6% with a minimum of 3.5% of ending unit value at the calculation date. Where unit values fall below the original gift amount (referred to as "underwater endowments"), distributions continue; however, these instances are monitored by the Board. There were no underwater endowments at June 30, 2019. Distributions amounted to approximately 4.0% and 4.3% of unit values in 2019 and 2018.

In establishing these policies, the Board considered the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, many of which must be maintained in perpetuity because of donor-restrictions, and the possible effects of inflation. The Board expects its spending policies to allow its endowment funds to grow at a rate consistent with the Board's objective to maintain the purchasing power of the endowment assets, as well as to provide additional growth through investment return.

Cash and Cash Equivalents

The Foundation considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash balances are maintained with various banks, the amounts of which may at times exceed federally insured limits. Credit risks associated with cash balances are mitigated by banking with credit worthy institutions. Cash equivalents comprise mainly federal money market funds

Perpetual Trusts

The Foundation is the beneficiary of perpetual trusts held and administered by outside trustees. These trust assets are reported at fair value. The related net assets are classified as with donor restrictions.

Property

The Foundation may receive property to be transferred to the School which is not capitalized. Otherwise, the Foundation capitalizes property with a value over $5,000. Lesser amounts are expensed. Property is stated at cost at date of acquisition or fair value at date of donation in the case of gifts. Depreciation is computed using the straight-line method over the assets assigned useful life.

2. Summary of Significant Accounting Policies (Concluded)

Income Taxes
The Foundation is exempt from income taxes on related income under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code. No material unrelated business taxable income has been identified by management. Accordingly, no provision for income taxes is made in the consolidated financial statements.

It is the Foundation's policy to evaluate all tax positions and to identify any that may be considered uncertain. All identified material tax positions are assessed and measured by a "more-likely-than-not" threshold to determine if the tax position is uncertain and what, if any, the effect of the uncertain tax position may have on the consolidated financial statements. Any changes in the amount of a tax position will be recognized in the period the change occurs. Currently, the statute of limitations remains open subsequent to and including fiscal year 2016; however, no examinations are in process.

Functional Expenses
The Foundation's payments and expenses are directly attributable to specific School programs or support or administrative costs. Therefore, the preparation of the consolidated statement of functional expenses does not require estimation for allocation of expenses by functional category.

Reclassifications
Certain prior year balances have been reclassified to conform to the current year presentation.

Subsequent Events
Management has evaluated events occurring subsequent to the date of the consolidated statement of financial position through August 30, 2019, the date that the consolidated financial statements were available to be issued, determining no events require adjustment to or additional disclosure in the consolidated financial statements.

3. Fair Value of Financial Instruments and Investments

The fair value of cash and cash equivalents, accounts payable and accrued expenses is not materially different than their carrying amounts, as reported, since they approximate the amount for which the assets could be sold or the liabilities could be settled. The discount rate used for pledges receivable approximates a market interest rate. Accordingly, the carrying value approximates fair value. The fair value of annuity obligations approximate carrying amounts as discount rates on these obligations approximate market. Investments are carried at fair value.

Assets and liabilities carried at fair value are classified and disclosed in one of the following three categories.

Level 1: Quoted market prices in active markets for identical assets or liabilities;
Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data;
Level 3: Unobservable inputs that are not corroborated by market data.

3. Fair Value of Financial Instruments and Investments (Concluded)

The following are the assets and liabilities measured at fair value as of June 30, 2019.

	Level 1	Level 2	Level 3	Total
Assets:				
Mutual funds (annuity investments)	$ 11,100	$ -	$ -	$ 11,100
Liabilities:				
Annuity obligations	$ -	$ -	$ 18,164	$ 18,164

The following are the assets and liabilities measured at fair value as of June 30, 2018.

	Level 1	Level 2	Level 3	Total
Assets:				
Mutual funds (annuity investments)	$ 13,685	$ -	$ -	$ 13,685
Liabilities:				
Annuity obligations	$ -	$ -	$ 24,121	$ 24,121

The following table summarizes changes in fair value of the Foundation's Level 3 liabilities for the year.

June 30,	**2019**	2018
Balance, beginning of year	**$ 24,121**	$ 47,111
Payments to annuitants	**(5,528)**	(24,831)
Amortization and change in assumptions	**(429)**	1,841
Balance, end of year	**$ 18,164**	$ 24,121

Topic 820 Fair Value Measurement, Subtopic 820-10, provides a practical expedient allowing investments that are measured at fair value using the net asset value per share (or its equivalent) not to be classified in the fair value hierarchy. The Foundation's investments with UNCIF (Note 2) are measured at net asset value and are therefore excluded from the above analysis.

4. Pledges Receivable, Net

Pledges receivable, net consist of the following:

June 30,	**2019**	2018
Due within one year	**$ 3,347,623**	$ 1,654,440
Due in one to five years	**5,912,775**	7,491,792
Due in more than five years	**642,000**	744,000
Total unconditional pledges	**9,902,398**	9,890,232
Less:		
Allowance for uncollectible pledges	**(396,096)**	(395,696)
Discount to present value – 4.5%	**(518,651)**	(717,639)
	$ 8,987,651	$ 8,776,897

5. Property

Property consists of the following:

June 30,	**2019**	2018
Land	**$ 60,000**	$ 60,000
Buildings	**1**	1
Total property	**$ 60,001**	$ 60,001

6. Liquidity and Availability

Financial assets available for general expenditure within one year of June 30 are as follows:

	2019	2018
Total assets	**$76,961,641**	$ 64,476,027
Endowment funds with donor restrictions	**62,156,217**	51,022,834
Annuity investments	**11,100**	13,685
Prepaid expenses	**52,202**	53,788
Assets to be transferred to UNCSA	**121,348**	56,222
Pledges receivable due greater than one year	**6,554,775**	8,235,792
Beneficial interests in perpetual trusts	**751,062**	790,400
Property	**60,001**	60,001
Other assets	**14,558**	67,896
Board appropriated	**247,450**	91,731
Total assets available for general expenditures	**$ 6,992,928**	$ 4,083,678

As part of the Foundation's liquidity management, financial assets are structured to be available for general expenditures, liabilities and obligations as they become due. Cash in excess of daily requirements are invested in cash equivalents primarily federal money market funds.

7. Restrictions on Net Assets

Net assets with donor restrictions are available for the following purposes:

June 30,	**2019**	2018
Time or purpose restrictions		
School programs	**$11,543,889**	$ 11,000,735
Endowment returns subject to future appropriation	**12,598,108**	10,594,642
Perpetual restrictions		
Permanent endowment funds	**49,558,109**	40,428,766
Underwater endowments	**-**	(574)
Annuity and other split-interest agreements	**7,494**	57,460
Interest in perpetual trusts held by others	**751,062**	790,400
Total net assets with donor restrictions	**$74,458,662**	$ 62,871,429

In 2019 and 2018, Board appropriated net assets without donor restrictions represent amounts set aside for office renovations.

8. Endowment Net Assets

Changes in endowment net assets during the year ended June 30, 2019 are as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets, beginning of year	$ -	$ 51,022,834	$ 51,022,834
Gifts and grants	-	8,990,357	8,990,357
Realized and unrealized gains, net	-	3,798,258	3,798,258
Investment management fees	(239,001)	-	(239,001)
Amounts appropriated for expenditure, reclassifications and transfers	239,001	(1,655,232)	(1,416,231)
Endowment net assets, end of year	$ -	$ 62,156,217	$ 62,156,217

Changes in endowment net assets during the year ended June 30, 2018 are as follows:

	Without Donor Restrictions	With Donor Restrictions	Total
Endowment net assets (deficit), beginning of year	$ (2,230)	$ 44,983,008	$ 44,980,778
Gifts and grants	-	2,485,125	2,485,125
Realized and unrealized gains, net	2,915	4,804,092	4,807,007
Investment management fees	(212,328)	-	(212,328)
Amounts appropriated for expenditure, reclassifications and transfers	211,643	(1,249,391)	(1,037,748)
Endowment net assets, end of year	$ -	$ 51,022,834	$ 51,022,834

9. Kenan Funds

During fiscal 2018, funds held for the Thomas S. Kenan Institute for the Arts at the University of North Carolina School of the Arts (a component of the School) ("TSKIA") were restricted for purposes of TSKIA and the Foundation Board had fiduciary oversight of these funds. The Foundation and the School agreed that effective July 1, 2018, TSKIA funds would be administered by a nonprofit corporation which is separate from the Foundation and a component of the School. As the School's Board of Trustees have assumed fiduciary responsibility, the Foundation recorded a transfer of net assets amounting to approximately $655,000 at June 30, 2018, which is included in amount due to UNCSA in the consolidated statement of financial position as of June 30, 2018. The funds were transferred during 2019.

10. Related Party Transactions

Reimbursements to the School for school employees assigned to the Foundation amounted to approximately $218,000 and $274,000 in 2019 and 2018. Reimbursements to the School for school employee supplements amounted to approximately $565,000 and $381,000 in 2019 and 2018. The School also provides the Foundation with various services, including office space, technology and legal services. In fiscal 2019 and 2018, the Foundation recorded expenses of approximately $8,800 and $7,900 for services provided by employees of the School and also other income for the same amount.

At June 30, 2019, approximately $196,000 is due to the School, which includes approximately $121,000 related to equipment transfers and approximately $75,000 for salary and miscellaneous reimbursements.

At June 30, 2018, approximately $734,000 was due to the School, which included approximately $655,000 related to TSKIA funds (Note 9), as well as equipment and miscellaneous reimbursements. Reimbursements for Kenan Institute employees paid by the Foundation, which were funded by a Kenan grant, amounted to approximately $452,500 in 2018.

11. Investment Income

Net gain on other investments reported at fair value consist of the following:

Year ended June 30,	**2019**	2018
Gain on investments reported at fair value	**$ 3,798,258**	$ 4,807,007
Investment management fees	**239,001**	212,328
	$ 3,559,257	$ 4,594,679

12. Commitments and Contingencies

Retirement Plan

The Foundation contributes to a retirement account a percentage based on its employee's salary. Contributions amounted to approximately $12,000 and $11,000 in 2019 and 2018.

Environmental Exposure

During 1995, a property valued at $241,000 was donated to the Foundation. The gift document provides that the Foundation indemnify the donor for any claims related to contamination of the property. The property contained areas of contaminated soil and heavy metal contamination in the building. During 2005, soil remediation was done and management believes that the remaining exposure in this area is minimal. However, the heavy metal contamination has not been remediated. Management estimates for remediating the building are between $200,000 and $950,000, depending on factors such as whether the building will be demolished or cleaned for re-use.

The Foundation does not intend to use its resources to remediate and there is no lawsuit or administrative action against the Foundation related to this matter. Accordingly, the Foundation has not recorded a liability for remediation costs and carries the building on its consolidated statements of financial position at $1.

13. Recent Accounting Pronouncements

In May 2014, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which provides guidance on the recognition of revenue. The ASU, as amended, is effective for periods beginning after December 15, 2018, with early application permitted. Management is assessing the impact this guidance may have on the Foundation's future consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which replaces all previous guidance on leases and will require entities to recognize assets and liabilities arising from operating leases. For the Foundation, the ASU (as amended) is effective for fiscal years beginning after December 15, 2019, with early application permitted. In July 2018, the FASB issued ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which provided an alternative transition method when initially applying ASU 2016-02. Entities may elect to apply ASU 2016-02 at the beginning of the earliest period presented or recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. Management is currently assessing the impact this guidance will have on the Foundation's future consolidated financial statements.

In August 2016, FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments*, which clarifies how certain cash receipts and payments are presented and classified in the statement of cash flows. For the Foundation, the ASU is effective for fiscal years beginning after December 15, 2018, with early application permitted. Management does not expect this update to materially impact the Foundation's consolidated financial statements.

In August 2018, FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which modifies disclosure requirements related to fair value measurements. The ASU is effective for fiscal years beginning after December 15, 2019, with early application permitted. Management does not expect this guidance to materially impact the Foundation's future consolidated financial statements.

In March 2019, FASB issued ASU No. 2019-03, *Not-for-Profit Entities (Topic 958), Updating the Definition of Collections*, which expands the criteria under which contribution of works of art and similar assets need not be recognized. The ASU is effective for fiscal year beginning after December 15, 2019. Management does not expect this guidance to materially impact the Foundation's future consolidated financial statements.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

MEETING OF THE BOARD OF TRUSTEES

Audit, Risk, and Compliance Committee
Tuesday, September 24, 2019
4 – 5:00 PM

AGENDA ITEM

Internal Audit Activity Update…….. *presented by Rod Isom, Internal Audit Manager & Shannon Henry, Chief Audit, Risk, and Compliance Officer*

Summary:

1. Internal Audit Reports**
    - Vendor Contract Follow-up Report
    - Risk Monitoring Memo – Worker Classification for Federal Tax Purposes
    - Risk Monitoring Memo – Business Continuity Management
2. Other Internal Audit Activity**
    - Reviews in Progress
    - Follow-up Memos
        - A request for actions taken to address findings sent for a response.
        - Follow-ups will be conducted accordingly.
3. Fiscal Year 2019 Recap
    - The following are the results from fiscal year 2019 audit activity:
        - Completed audits and advisory services resulting in reports that produced 23 written recommendations and 9 verbal recommendations for improvements in the following university offices or departments: Controller's Office, Finance & Administration, Information Technology, Purchasing, Human Resources, Provost's Office, Chief of Staff, General Counsel, and CDI.
        - Results of Annual KPI's
4. Annual Risk Assessment and Internal Audit Plan**
    - The annual process to identify, measure, and prioritize risks is complete. The ongoing Internal Audit Plan has been adjusted to reflect projects that will address current risks considered to have the highest impact and likelihood of occurring and negatively impacting the university's ability to achieve its objectives.
5. Memorandum of Understanding
6. QAR Process
    - The Internal Audit department is due for its Quality Assessment Review and is in the process of performing a self-assessment with validation by an independent external assessor for conformance with the Institute of Auditors' International Standards for the Professional Practices of Internal Auditing.
7. Review Committee and Office Charters
    - Internal Auditing Standards require a periodic review of the Internal Audit Charter by senior management and the board.
        - The ARCC is charged to direct and/or oversee the university's activities and hold senior management accountable.
        - The Internal Audit Charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. It further establishes the activity's position within the organization; authorizes access to records,

personnel, and physical properties relevant to the performance of engagements; and defines the scope of audit activities.

***Additional information related to this item or any internal audits or reviews released prior to the meeting will be provided at the meeting.*

Action: These items are for informational purposes only.

Office of Audit, Risk, and Compliance
Shannon B. Henry, Chief Audit, Risk, and Compliance Officer
1600 Lowery Street, Winston-Salem, North Carolina 27110
(336) 750-2065 | www.wssu.edu

June 29, 2019

Mr. Michael Smith
Vice Chancellor for Finance and Administration
University of North Carolina School of the Arts
1533 South Main Street
Winston-Salem, NC 27127

Dear Mr. Smith:

The Internal Audit Unit (IA) of Winston-Salem State University's (WSSU) Office of Audit, Risk, and Compliance's follow-up review to evaluate the University of North Carolina School of the Arts' (UNCSA) progress toward resolving previously reported observations related to vendor contract payments is complete.

The following report includes a restatement of the original observation and recommendations, updates since the last review to include management's corrective actions, and IA's opinion about the resolution status of the original observations.

Engagements completed by IA at WSSU are conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*, published by the Institute of Internal Auditors.

Respectfully submitted,

Shannon B. Henry

Shannon B. Henry
Chief Audit, Risk, and Compliance Officer

cc: Lindsay Bierman, Chancellor
David Harrison, General Counsel
Lisa McClinton, Associate Vice Chancellor for Finance and Controller

Jeannette Valentine, Director of Purchasing, Contract, and Auxiliary Services
Audit, Risk, and Compliance Committee, UNCSA Board of Trustees

TABLE OF CONTENTS

BACKGROUND, OBJECTIVE, AND SCOPE

BACKGROUND:

This report addresses the status of previous observations released in an IA report, on June 2, 2014, related to the university's practices regarding vendor contract payments. At the conclusion of the IA review, observations and recommendations were reported to management and, subsequently, management action plans were developed to explain how the agreed upon recommendations would be implemented.

The purpose of this follow-up review was to ascertain whether the university sufficiently addressed the observations and implemented actions that were lasting or if senior management sufficiently evaluated and considered the risk of not taking action to address the reported observations.

OBJECTIVE:

The objective of the review was as follows:

- To evaluate the university's progress toward resolving findings included in the prior audit report.

To conduct the review, IA performed the following procedures:

- Reviewed university policies and procedures;
- Interviewed university employees; and
- Examined, on a test basis, evidence supporting internal controls and compliance.

SCOPE:

The scope of the review was the calendar year 2018.

This report presents the results of IA's review.

SUMMARY OF RESULTS

IA found evidence of efforts to implement the previous audit's recommendations and tighten controls. It is IA's opinion that the university has sufficiently mitigated the risks associated with noncompliance and fraud related to vendor contracts.

During the review, IA noted minor issues related to the initial observations that have been communicated to management verbally and will be documented by way of a risk monitoring memo, with no response required.

See the section entitled, *Restated Observations, Recommendations, and Resolution Status,* for the details and results of IA's follow-up review.

RESTATED OBSERVATIONS, RECOMMENDATIONS, AND RESOLUTION STATUS

IA's review of the university's actions to resolve the observations noted in the prior IA review related to, "*The university's internal controls over vendor contracts being insufficient to ensure the university's resources are properly safeguarded and handled in compliance with governing regulations and university policies"*, revealed the following:

PRIOR YEAR OBSERVATION #1:

The Purchasing Director had the access and authority to process and approve university purchases, within his purchases limit of $50,000, with no review or independent verification required.

PRIOR YEAR RECOMMENDATIONS:

The university should strengthen its internal controls over purchasing functions by implementing procedures to ensure that no one individual has the access and authority to handle transactions from beginning to end and that all purchase transactions are appropriately verified.

PRIOR YEAR RESPONSE FROM UNIVERSITY MANAGEMENT:

The Purchasing Department has implemented tighter internal controls within the Banner Finance module. System access has been modified for the Director of Purchasing. As of May 6th, all transactions resulting in the creation and modification of purchase orders completed by the Director of Purchasing will require electronic approval within the Banner Finance module by the Senior Director of Business Affairs, or her delegate, before the order is processed. The Director of Purchasing will approve electronically all other purchase order transactions. This change separated the processes in order to prevent one person having the authority to create, modify and approve a purchase.

INTERNAL AUDIT'S FOLLOW-UP REVIEW OF ACTIONS TAKEN BY MANAGEMENT

UPDATES SINCE THE LAST REVIEW:

- The Purchasing Director's (whose title changed to the "Director of Purchasing, Contract, and Auxiliary Services", and is hereinafter referred to in the report as "Director") authority to process and approve purchases was increased from $50,000 to $100,000. The position's access rights have not been modified, so the Director still has the ability to approve purchases that he or she processes. Additionally, through observation and inquiry of management, the Purchasing Specialist has the same level of access and authority to purchase as the Director.

According to management, this level of access is necessary for the department to function appropriately, considering the small-sized staff.

- Management's response to the initial review provided that purchase orders created and modified by the Director would be approved by the Senior Director of Business Affairs (hereinafter referred to as the "Vice Chancellor for Finance & Administration" due to a title change), or his or her delegate. IA tested 9 of 40 (23%) purchase order transactions that originated out of Purchasing and noted no evidence of approval by the Vice Chancellor for Finance & Administration. Of those 9, four (44%) were created by the Director.

While the university's actions were not consistent with its initial response, the following checks and balances and compensating controls noted in other related administrative areas sufficiently address the risks identified in the Purchasing Department:

CHECKS AND BALANCES AND SEPARATE HANDLING:

- The goods and services purchased are checked against the purchase order by receiving personnel, a separate administrative function in Finance. No one in the Purchasing Department has access to receive;
- Goods and services must be received before payment is processed. The review identified that the personnel in Accounts Payable, a separate accounting function, check the goods received and services rendered, to the purchase order, before processing payment;
- During the review, there was no evidence of an individual in the Purchasing Department completing an intradepartmental purchase from beginning to end without independent review of the financial transaction by another party;

BUDGETARY RESTRICTIONS AND OVERSIGHT:

- The system used to enter purchase orders electronically has automated controls, including a non-sufficient funds checking terminal that does not allow an individual to create a purchase order without having funds available in their departmental budget. Based on IA's review and inquiry of management, the Purchasing Department's budget is set by the Vice Chancellor for Finance and Administration;
- The Purchasing Department's budget for fiscal year 2018 was $270,258. However, $258,629 (96%) was related to salaries and benefits. The department's remaining expenses were $11,849, constituting only 4% of the budget.

INTERNAL AUDIT OPINION:

Based on IA's review of the way in which the university manages and processes it's financial transactions, it appears the level of financial and fraud risk in this area is

sufficiently mitigated through the overall system of checks and balances in Finance. As a result, it is IA's opinion that the university has satisfactorily ***resolved*** this issue.

There were other minor observations identified during IA's follow-up review. These observations have been communicated to management verbally and will be documented by way of a risk monitoring memo, with no response required.

PRIOR YEAR OBSERVATION #2:

The Purchasing Department's processes to ensure vendor contract payments are in compliance with state and university policies are not consistently followed.

PRIOR YEAR RECOMMENDATIONS:

The Purchasing Department should establish controls to ensure compliance with its internal procedures. Relevant employees should receive appropriate training on these procedures and controls for consistent application.

PRIOR YEAR MANAGEMENT'S RESPONSE:

The Purchasing Director retrained the employees within the Purchasing Department on the proper process for "working up" requisitions and ensuring accuracy and proper completion of the Requisition Checklist. The checklist ensures that all requisitions are compliant with University and State Policies. The Director of Purchasing reinforced their understanding of all processes required to properly verify information for a requisition and the importance of consistency.

INTERNAL AUDIT'S FOLLOW-UP REVIEW OF ACTIONS TAKEN BY MANAGEMENT

CORRECTIVE ACTIONS IMPLEMENTED BY UNIVERSITY MANAGEMENT:

- IA tested 40 purchase orders and noted that, in all cases, the compliance checklist, which ensures purchase orders are in compliance with state and university policies, were complete.
- IA examined training records and noted all relevant employees, within the Purchasing Department, have received training on processing the department's internal transactions. Training topics covered included: requisition processing, P-card processing, contracts for procurement purposes, and bid processing.

INTERNAL AUDIT OPINION:

This observation has been ***resolved***.

RESTATED OBSERVATIONS, RECOMMENDATIONS, AND RESOLUTION STATUS

There were other minor observations identified during IA's follow-up review. These observations have been communicated to management verbally and will be documented by way of a risk monitoring memo, with no response required.

PRIOR YEAR OBSERVATION #3:

The university's existing Independent Contractor Certification Form does not appear to adequately address the factors provided by the Internal Revenue Service (IRS) to assist organizations with worker classification.

PRIOR YEAR RECOMMENDATIONS:

The university should review and update the Independent Contractor Certification Form to include the factors provided by the IRS to help determine worker classification and ensure compliance with federal laws and regulations. Further, the university should consider including the Office of Human Resources as an approver on the form to ensure the university's relationship with each worker is wholly considered.

PRIOR YEAR MANAGEMENT'S RESPONSE:

The Controller updated the Independent Contractor Certification form to ensure compliance with federal laws and regulations. The form now lists fourteen questions for the hiring department to answer. This will provide us a better understanding of the worker's duties they are being hired to perform. In addition, we have included the Human Resources office in the signature routing in order to ensure continuing relationships are evaluated properly.

INTERNAL AUDIT'S FOLLOW-UP REVIEW OF ACTIONS TAKEN BY MANAGEMENT

CORRECTIVE ACTIONS IMPLEMENTED BY UNIVERSITY MANAGEMENT:

- The university's Independent Contractor Certification Form was updated to include key factors provided by the IRS to help determine worker classification and ensure compliance with federal laws and regulations.
- Human Resources (HR) was added to the form as an approver to ensure the university's relationship with each worker is wholly considered.
- During IA's review of vendors identified as independent contractors, IA tested 21 (15%) of the 138 independent contractors and noted where the factors provided by the IRS had been considered in determining classification and that the appropriate signatures, including HR, had been obtained.

RESTATED OBSERVATIONS, RECOMMENDATIONS, AND RESOLUTION STATUS

There was a minor observation, related to this area, identified during IA's review that was outside of the IA testing population. This has been communicated to management verbally and will be documented by way of a risk monitoring memo, with no response required.

INTERNAL AUDIT OPINION:

IA considers this observation ***resolved.***

Winston-Salem State University | University of North Carolina School of the Arts
Office of Audit, Risk, and Compliance
1600 Lowery Street, Winston-Salem, North Carolina 27110
phone 336.750.2065 | fax 336.750-8891
www.wssu.edu | www.uncsa.edu

Memorandum

To: Angela Mahoney, Director of Human Resources
Lisa McClinton, Associate Vice Chancellor for Finance and Controller

From: Shannon B. Henry, Chief Audit, Risk, and Compliance Officer SBH

Date: August 9, 2019

Re: Notification of Risk Identification – Worker Classification for Federal Tax Purposes

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The Internal Audit Unit (IA) of Winston-Salem State University's (WSSU) Office of Audit, Risk, and Compliance recently completed a follow-up review of the University of North Carolina School of the Arts' (UNCSA) processes related to vendor contract payments. During that review, IA noted areas, where controls should be strengthened, that were considered minor or outside of the scope of the review. It is important to note that further examination of these areas is not included on the current audit focus list; however, the assessment of potential risk for loss or reputational damage is appreciable.

Specifically, we noted that the university is not considering new hires' existing, or pre-existing, independent contractor relationships with the university. During our testwork, we identified an individual whose employment classification status as an independent contractor and a temporary employee overlapped, resulting in the individual being paid as an independent contractor and a temporary employee simultaneously.

As it stands, UNCSA's Temporary Hourly Employee Form 301 does not provide sufficient considerations for an individual's relationship with the university to be wholly considered.

As persons responsible for oversight of the control environment surrounding worker classification for federal tax purposes, we are writing to encourage you to exercise greater than

routine vigilance to ensure individuals' on-going relationships with the university are being evaluated in accordance with university policy and Internal Revenue Service guidelines. IA recommends that the university consider the circumstances surrounding the individual identified in this communication and rectify any noncompliance. Further, IA recommends that the Temporary Hourly Employee Form 301 be updated to include questions that allow all existing or pre-existing relationships to be considered.

We also encourage you to bring to our attention any other potential deficiencies in controls and procedures you believe may pose any risks so that we may help you identify and implement solutions.

REVIEW CRITERIA:

IRS Tax Topic 762, "Independent Contractor vs. Employee" states:

> For federal employment tax purposes…you must examine the relationship between the worker and the business. All evidence of the degree of control and independence in this relationship should be considered. The facts that provide this evidence fall into three categories – Behavioral Control, Financial Control, and the Relationship of the Parties.
>
> "Relationship of the Parties" covers facts that show the type of relationship the parties had. This includes:
>
> - Written contracts describing the relationship the parties intended to create;
> - Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay;
> - The permanency of the relationship; and
> - The extent to which services performed by the worker are a key aspect of the regular business of the company.

The Joint Committee on Taxation, *Present Law and Background Relating to Worker Classification for Federal Tax Purposes,* states:

> Significant tax consequences result from the classification of a worker as an employee or independent contractor. Significant tax consequences also result if a worker was misclassified and is subsequently reclassified, e.g., as a result of an audit. For the service recipient, such consequences may include liability for withholding taxes for a number of years, interest and penalties, and potential disqualification of employee benefit plans. For the worker, such consequences may include liability for self-employment taxes and denial of certain business-related deductions.

The "Purpose" section of UNCSA's Independent Contractor Policy #306 states:

> This policy has been developed to set forth UNCSA policy and procedures for the engagement of independent contractors. Because significant tax penalties may be imposed for incorrectly classifying an employee as an independent contractor and the University may be exposed to unnecessary legal liability in the contracting process, it is important that UNCSA address these issues by defining a common standard in the way it conducts activities with external individuals and organizations. The IRS levies costly fines and penalties if it determines that an individual should have been paid as an employee and the organization paid the individual as an independent contractor.

Engagements completed by IA at WSSU are conducted in conformance with the *International Standards for the Professional Practice of Internal Auditing*, published by the Institute of Internal Auditors.

cc: Brian Cole, Interim Chancellor
Michael Smith, Vice Chancellor for Finance and Administration
Audit, Risk, and Compliance Committee, UNCSA Board of Trustees

Office of Audit, Risk & Compliance
Shannon B. Henry, Chief Audit, Risk and Compliance Officer
1600 Lowery Street, Winston-Salem NC 27110
(336) 750-2065 | henrysb@wssu.edu

Memorandum

To: Michael Smith, Vice Chancellor for Finance and Administration
Terry Harmon, Chief Technology Officer
Frank Brinkley, Police Chief

From: Shannon B. Henry, Chief Audit, Risk, and Compliance Officer SBH

Date: June 30, 2019

Re: Risk Monitoring for Business Continuity Management at UNCSA

The purpose of this communication is to make you aware of previous reports of findings released by the Internal Audit Unit of the WSSU Office of Audit, Risk, and Compliance concerning the university's Business Continuity Management Program, an area for which you have oversight responsibility. Subsequent to the review, management action plans were developed to explain how the agreed upon recommendations would be implemented.

It is important to note that a review of this area is not part of the current audit focus list, however, the auditor's previous assessment of the university's exposure to loss was appreciable. Thus, we are writing you, as a person responsible for oversight of the university's Business Continuity Management Program, to encourage you to exercise greater than routine vigilance to ensure issues have been sufficiently addressed and your employees adhere to the internal controls and procedures in place to mitigate risks.

Internal Audit's resources for fiscal year 2019-2020 will be allocated based on present high priority concerns along with the results of the university-wide risk assessment. In the meantime, we encourage you to bring to our attention any deficiencies in those controls and procedures you believe may expose the university to potential losses so that we may help you identify and implement solutions.

Thank you very much for your attention to this matter, and please contact us if you have any questions.

Enclosure: Internal Audit's Business Continuity Management Review Report & Management Letter

Office of Audit, Risk, & Compliance
Shannon B. Henry, Chief Audit, Risk, and Compliance Officer
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Memorandum

To: Steve Martin, Associate Vice Chancellor for Facilities Management

From: Shannon B. Henry, Chief Audit, Risk, and Compliance Officer SBH

Date: June 30, 2019

Re: Follow-up to Internal Audit's Housekeeping Survey Report

At the conclusion of Internal Audit's survey and review of housekeeping services at UNCSA, findings and proposed recommendations were discussed with management and, subsequently, management action plans were developed to explain how the agreed upon recommendations would be implemented. The purpose of this communication is to follow up on the status of the recommended actions to ensure management has implemented corrective measures, and sufficiently addressed the issues.

Following is a summary of the observations identified from Internal Audit's survey and review report:

1. Dissatisfaction with Housekeeping Services Institution-Wide;
2. Performance of Housekeeping Services Needs Improvement within Specific Facilities / Disparity in the Quality of Housekeeping Work;
3. Ineffective Management of Facilities;
4. Front-line Supervision Needs Improvement / A Lack of Proper Oversight or Accountability Over the Housekeeping Staff;
5. High Level of Discontent Pertaining to the Cleanliness of Restrooms;
6. Trends that Threaten the Quality of Housekeeping Work; and a
7. Lack of Resources

Internal Audit's Recommendations:

1. UNCSA should identify and empower individuals or groups who will 1) set the course for addressing the concerns identified in this report; 2) ensure corrective measures are implemented in a timely manner; and 3) ensure regular communication within the Housekeeping staff and between UNCSA leadership.
2. Management should work with Human Resources (HR) and senior management to review the Housekeeping structure and determine if resources could be obtained to help with the understaffing issue. The University should give Housekeeping management the opportunity to gain the requisite skills and abilities to perform their job at a satisfactory level within a specific timeframe. Clear policies, procedures, and accountability measures pertaining to work quality expectations, discipline, and problem resolution should be established.
3. Training should cover a wide range of topics to include: managing, supervising, work ethic and expectations, and accountability. Additionally, management and supervisory training should be specifically designed to address the issues identified in the survey report. Training sessions should be specific to the needs of the Housekeeping staff and management and should address campus-wide expectations.
4. Mandatory meetings with all Housekeeping management should be conducted to review the results of this report. Management should consider developing a "Safe to Say" or survey program that encourages faculty, staff, and students to report or comment on behaviors that are not in line with core values, or share ideas that may make the organization better and hold managers accountable. Additionally, the "Safe to say" program can also be used to encourage employees to report instances of discrimination, harassment, and intimidation in a safe environment. Gestures of appreciation or recognition of a job well done should be provided.
5. Formal team-building activities should be arranged to encourage employees who do not share a common quality of work to work towards a common goal. A plan to re-engage Housekeeping staff and encourage the staff to perform their duties well should be developed.
6. Students should be encouraged to help keep the campus clean and beautiful, and littering the campus should be discouraged.
7. Periodic reviews of any and all newly implemented policies, procedures, and practices should take place to ensure that they are having the desired effect and are consistently being followed.
8. Management should consider surveying other divisions within Facilities Management to determine if any potential problems exist.
9. Management must take a visible role in leading the change process to enhance the quality of work in Housekeeping.

Management's responses to the issues and recommendations were as follows:

- The University is currently developing a request for proposal that will allow us to engage an industry leading firm for consultation services. The goal of the consultant services will

be to provide recommendations on organizational structure, work-loading standards, quality control, training programs, cleaning programs and a staffing and resource plan. The current schedule is to have the consultant on campus in February 2016 and a report by May 2016. The University has completed a review of employee attendance and is meeting regularly with the staff to develop a stronger work culture.

- The University has begun to research and identify best practice handbooks that will be used to develop the UNCSA housekeeping services handbook. The handbook is currently scheduled to be completed immediately after the consultant's work is completed, in May 2016.
- The University will utilize the consultant's report and recommendations to improve quality control, develop equitable workloads and identify current training needs. As stated previously, this report should be available in May 2016.
- The University has already done much work in this area including an increase from bi- annual to quarterly meetings with the AVC FMD. The first quarterly meeting was held in October 2015. In addition, the supervisors have set a goal to have bi-weekly staff meetings beginning in November 2015. The University has also held a meeting in November 2015, led by Human Resources, that included work ethic, absenteeism and Title IX training and discussions. The University implemented the monthly award program for our top performing housekeeper starting in October 2015.
- The University has identified Qualtrics as the survey software to be used for future feedback surveys. The first survey is in development and is expected to be published in January 2016. The Housekeeping Services Working Group will be organized and begin meeting in February 2016. An anonymous staff feedback system will be developed and implemented in March 2016.
- The Facilities Management Department has completed a restroom evaluation for all campus restrooms and is in the process of determining priorities for improvements. A plan for flooring replacements has not yet been completed, but is planned to be completed in the Spring 2016. These improvement plans will require significant funding and will be considered for funding based on availability and other campus high priority needs. As mentioned previously, the University has completed some improvements to residence hall common areas and bathrooms. In fact, the University invested almost $200,000 during the summer of 2015 on these improvements. As new funding becomes available, additional improvements will be made in the residence halls.

Please respond to this office by July 26, 2019, and let us know if and how the agreed upon actions were implemented or if management has measured and accepted the risk of not taking action. Please include any and all evidence necessary to corroborate your statements.

Thank you very much for your attention to this matter, and please contact us if you have any questions.

Office of Audit, Risk, & Compliance
Shannon B. Henry, Chief Audit, Risk, and Compliance Officer
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Memorandum

To: Terry Harmon, Chief Technology Officer

From: Shannon B. Henry, Chief Audit, Risk, and Compliance Officer SBH

Date: June 30, 2019

Re: Follow-up to Internal Audit's Operational Review of Information Technology at UNCSA

At the conclusion of Internal Audit's operational review of Information Technology, findings and proposed recommendations were discussed with management and, subsequently, management action plans were developed to explain how the agreed upon recommendations would be implemented. The purpose of this communication is to follow up on the status of the recommended actions to ensure management has implemented corrective measures, and sufficiently addressed the issues.

Following is a summary of the issues identified during Internal Audit's, and the accompanying recommendations:

1. Insufficient IT Gap Analysis and Risk Assessment:
    - The IT department did not specifically identify all the gaps within their gap analysis (crosswalk), nor were there descriptive plans for compliance, mitigation, or alternative controls for such gaps identified within their risk assessment. Failing to complete the gap analysis and risk assessment processes increases the university's risk of noncompliance with standards and can prevent management from identifying and mitigating risks.
2. Outdated Information Security Policy:
    - IT does not have a comprehensive information security policy in place to comply with ISO 27002 standards. Failing to develop a compliant and comprehensive security policy could lead to an increased risk of exposure or loss of university data, systems, or network failure, which could be a significant liability to the university.

3. Incomplete Data Classification:
    - IT has not documented how information is classified in a manner that ensures an appropriate level of protection based upon its importance to the organization. Failing to provide the proper guidance relative to data classification could result in information being mismanaged or compromised and loss or liability to the university.

4. Operating Procedures Not Documented:
    - IT has not documented its key operating procedures. A lack of documented procedures puts the university at risk of noncompliance with university and state policies.

5. Campus Community Concerns:
    - During our review of IT's operations, we used an online survey tool to survey the campus community and record responses. The survey was available from April 17, 2016 – May 16, 2016 and yielded 215 responses. The survey contained 14 questions, several of which allowed participants to comment on issues they believed to be significant.

      We identified five common concerns; defined as those having at least 10 mentions (or 5% of responses):

      1) Lack of customer service from the helpdesk (29 mentions - 13%);
      2) Lack of IT resources as it relates to financial, personnel, and time (26 mentions - 12%);
      3) Wi-Fi issues in certain areas (21 mentions - 10%);
      4) Lack of knowledge among IT personnel (14 mentions - 7%); and
      5) Lack of support for Mac/Apple users (13 mentions - 6%).

MATTERS NOT SUBJECT TO DISCLOSURE UNDER PUBLIC LAW

6. [redacted]
    - [redacted]

[redacted]
    - [redacted]

Internal Audit's Recommendations:

1. The IT department should ensure gaps are clearly defined and the risk assessment displays how those gaps will be addressed and mitigated. The university should also ensure the risk

assessment process is comprehensive and addresses the likelihood of risk occurrence, risk significance, and how it can be managed properly.

2. The IT department should complete its new information security policy according to ISO 27002.
3. IT should ensure its data is classified in accordance with ISO 27002, specifically in terms of legal requirements, value, criticality, and sensitivity. In addition, IT should also ensure that guidance is documented on how the custodians should handle and/or protect the data and ensure the guidance is communicated to the data owners.
4. The IT department should develop and document operating procedures for each of its key processes.
5. The IT department should consider and address the concerns provided via the Internal Audit survey. Additionally, IT should occasionally survey the campus community in order to determine areas for improvement within IT.
6. [redacted]

Management's responses to the issues and recommendations were as follows:

- We concur with the recommendation that the Gap Analysis should feed more directly into the risk assessment. We are developing a Risk Management Plan for a target completion of Q3 2017. This new methodology should ensure more comprehensive risk management.
- References in the Gap Analysis that indicate a need for additional documentation are mostly procedures and processes which are known to key IT personnel but not recorded in electronic format. IT managers will concentrate on the development of missing process documentation in their areas, which relates directly to the Gap Analysis.
- We concur with the recommendation to review the draft document to verify the inclusion of all ISO 27002 security objectives. This document has been through a preliminary review and we expect to have it to senior management in Q1 2017.
- We concur with the recommendation to modify the draft document to include the additional data characteristics defining legal requirements, value, criticality and sensitivity. Indications will be added to denote the method in which the data is protected. We anticipate submitting to senior management in Q1 2017.
- We concur with the need of extensive documentation for our processes. We currently have over 28,000 files directly related to systems and application documentation.
- IT Management has developed a first pass of categorizing business processes in each of their respective areas. IT managers will concentrate on the collation and development of missing process documentation. The initial work will concentrate on processes noted in the Gap Analysis.
- We will form a review team comprised of senior management and the managers of the areas indicated by the feedback comments. This team will determine the focus areas which may be amendable to observable change within several months, and those that may take a year or more for change to be achieved. We are going to implement the survey

application within our Help Desk ticket tracking system for customer service feedback.

- We concur with the recommendation to review and approve the access rights of the five designated privileged user accounts within IT. We currently have a bi-annual security audit process where we produce over 250 approval pages for user accounts. We will add the five privileged accounts to this process in order to document supervisory approval.
- Vendor account creation requests and CTO approval are now documented in our project tracking system, ActiveCollab. Vendor accounts are set to have 90 day password expiration.

Please respond to this office by July 26, 2019, and let us know if and how the agreed upon actions were implemented or if management has measured and accepted the risk of not taking action. Please include any and all evidence necessary to corroborate your statements.

Thank you very much for your attention to this matter, and please contact us if you have any questions.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

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UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS INTERNAL AUDIT CHARTER

I. MISSION

The mission of Internal Audit is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight. Internal Audit helps the university accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

II. SCOPE

The Winston-Salem State University Office of Audit, Risk, and Compliance is the internal audit service provider for the University of North Carolina School of the Arts. The scope of work of the Office of Audit, Risk, and Compliance is to determine whether the university's network of risk management, control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

1. Risks are appropriately identified and managed.
2. Interaction with the various governance groups occur as needed.
3. Significant financial, managerial, and operating information is accurate, reliable, and timely.
4. Employee's actions are in compliance with policies, standards, procedures, and applicable laws and regulations.
5. Resources are acquired economically, used efficiently, and adequately protected.
6. Programs, plans, and objectives are achieved.
7. Quality and continuous improvement are fostered in the university's control processes.
8. Significant legislative and regulatory issues impacting the university are recognized and addressed properly.

Opportunities for improving risk management, management control, efficiency, compliance, and the university's image may be identified during audits. They will be communicated to the appropriate level of management.

III. INDEPENDENCE

Internal Audit shall maintain its independence. The Chief Audit Officer (CAO) reports administratively to the Chancellor and functionally to the Audit, Risk, and Compliance Committee (ARCC) of the university Board of Trustees in a manner outlined in the section on *Accountability*. Internal Audit staff personnel shall report to the CAO. The CAO shall include a report on internal audit personnel as part of the regularly scheduled ARCC meetings or upon request from the Chair of the ARCC.

IV. AUTHORITY

1. The CAO and staff are authorized to:

    a. Have unrestricted access to all functions, records, property, and personnel, in a manner consistent with North Carolina law.
    b. Have full and free access to the ARCC.
    c. Allocate resources, set frequencies, select subjects, determine scopes of work, and apply techniques required to accomplish audit objectives.
    d. Obtain the necessary assistance of personnel in units of the university where they perform audits, as well as other specialized services from within or outside the university.

2. The CAO and staff are not authorized to:

    a. Perform any operational duties for the university or its affiliates.
    b. Initiate or approve accounting transactions external to Internal Audit.
    c. Direct the activities of any university employee not employed by the Office of Audit, Risk, and Compliance.

V. ACCOUNTABILITY

The CAO, in the discharge of his/her duties, shall be accountable to the Chancellor and the ARCC to:

1. Provide an assessment on the adequacy and effectiveness of the university's processes for controlling its activities and managing its risks in the areas set forth under the mission and scope of work.
2. Report significant issues related to the processes for controlling the activities of the university and its affiliates, including potential improvements to those processes, and provide information concerning such issues through resolution.
3. Provide information periodically on the status and results of the annual audit plan and the sufficiency of department resources.
4. Coordinate with and provide oversight of other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental, external audit).

VI. RESPONSIBILITY

The CAO and staff have responsibility to:

1. Apply and uphold the principles and rules of conduct in the Code of Ethics established by the Institute of Internal Auditors (IIA).
2. Develop a flexible annual audit plan using an appropriate risk-based methodology, including any risks or control concerns identified by management, and submit that plan to the ARCC for review and approval.
3. Implement the annual audit plan, as approved, including, and as appropriate, any special tasks or projects requested by management and the ARCC.
4. Maintain a professional audit staff with sufficient knowledge, skills, experience, and professional certifications to meet the requirements of this Charter.
5. Establish a quality assessment program by which the CAO assures the operation of internal auditing activities.
6. Perform consulting services, beyond internal auditing's assurance services, to assist management

in meeting its objectives. Examples may include facilitation, process design, training and advisory services.

7. Evaluate and assess significant merging/consolidating functions and new or changing services, processes, operations, and control processes coincident with their development, implementation, and/or expansion.
8. Periodically report to the Chancellor and the ARCC summarizing the results of audit activities.
9. Communicate appropriate and significant risk findings to the University's General Counsel.
10. Keep the Chancellor and the ARCC informed of emerging trends and successful practices in internal auditing.
11. Provide significant goals and results to the ARCC.
12. Assist in the investigation of significant suspected fraudulent activities within the university and notify the Chancellor and the ARCC of the results.
13. Consider the scope of work of the external auditors and regulators, as appropriate, for the purpose of providing optimal audit coverage to the university.
14. Provide audit and/or activity reports to the University of North Carolina (UNC) Board of Governors, the UNC System Office, the North Carolina (NC) Office of State Budget Management, and the NC Office of the State Auditor.

VII. ROLES BEYOND INTERNAL AUDITING

To help ensure key business risks are being managed appropriately and that the system of internal control is operating effectively, the CAO's role has been expanded to include the following as it relates to the university's enterprise risk management (ERM) and compliance monitoring functions.

1. ENTERPRISE RISK MANAGEMENT

The CAO's roles related to ERM include the following:

a. Championing the establishment of ERM.
b. Facilitation of the processes to identify, evaluate, manage and monitor risks.
c. Advising, challenging, coaching and supporting management's decisions on risk, as opposed to making risk management decisions.
d. Assisting with the coordination of ERM activities.
e. Consolidating the reporting on risks.
f. Communicating with senior management and the ARCC when management has accepted a level of risk that may be unacceptable to the university.

2. COMPLIANCE

The CAO's role related to university-wide compliance monitoring includes the following:

a. Serve as the connector for individual components of university compliance.
b. Facilitate reports from compliance managers to the ARCC.
c. Report auditor observations of noncompliance to the ARCC.

To ensure these additional roles related to ERM and compliance do not impair, or appear to impair the organizational independence and objectivity of the CAO and the internal audit function, the following safeguards are in place:

1. The CAO reports administratively to the Chancellor and functionally to the ARCC.

2. The CAO does not own risks. University management remains responsible for risk management and compliance.
3. The CAO does not manage risks or compliance on behalf of management.
4. University management sets the risk appetite, makes decisions about and implements risk responses.
5. The ARCC and Chancellor are responsible for imposing risk management practices.
6. The ARCC will periodically evaluate reporting lines and responsibilities of the CAO and the internal auditors and develop alternative processes to obtain assurance related to ERM, if deemed necessary.

VIII. Standards of Audit Practice

The Office of Audit, Risk, and Compliance will meet or exceed the *International Standards for the Professional Practice of Internal Auditing (Standards)* of the IIA.

Effective Date: This Charter becomes effective upon adoption by the Board of Trustees.

Adopted: This the 9th day of February 2018

Michael D. Tiemann
Chair, Board of Trustees
UNC School of the Arts

Stephen R. Berlin
Chair, Audit, Risk, and Compliance Committee
UNC School of the Arts

UNIVERSITY OF NORTH CAROLINA
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University of North Carolina School of the Arts Board of Trustees Audit, Risk, and Compliance Committee Charter

I. PURPOSE

To assist the University of North Carolina School of the Arts (UNCSA) Board of Trustees in fulfilling its oversight responsibilities of the institution and associated entities which fall under the requirements established by the Board of Governors in the following areas:

1. The financial reporting process;
2. The effectiveness of the institution's internal control and enterprise risk management systems;
3. The audit process;
4. The information governance and security infrastructure;
5. The institution's process for monitoring compliance with laws and regulations; and
6. The institution's code of conduct.

The committee is responsible for providing open lines of communication between the university's internal audit, risk management, and compliance functions and the UNCSA Board of Trustees. The committee will take all appropriate actions to set the overall tone at the institution for quality financial reporting, effective internal control, risk management, and compliance systems, and ethical behavior. The University Chancellor, the Chief Audit Officer (CAO), and/or Audit, Risk and Compliance Committee (ARCC) Chair have the power to call a meeting whenever necessary.

II. AUTHORITY

The ARCC has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

1. Appoint, compensate, and oversee the work of the North Carolina Office of the State Auditor and any other registered public accounting firm employed by the organization;
2. Resolve any disagreements between management and the auditor regarding financial reporting;
3. Pre-approve all audit and related services;
4. Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation;
5. Seek any information it requires from employees — all of whom are directed to cooperate with the committee's requests — or external parties;
6. Meet with the organization's officers, external auditors, or outside counsel as necessary; and
7. Set the university's risk appetite.

III. COMPOSITION

1. The ARCC shall be a standing committee of at least three, and no more than six, members of the Board of Trustees.
2. The Chair of the Board will select both the chair of the ARCC and the members of the committee.
3. The Chair of the Board will serve as an ex officio member of the ARCC.

4. Voting committee members must be comprised only of trustees, however, committee members may be non-trustees. Non-trustee committee members shall have all of the rights and responsibilities of trustee members, except the right to vote.
5. Each ARCC member must be independent of UNCSA management and free of any relationship that would impair such independence. Members may not receive from UNCSA any consulting, advisory, or other fees paid monetarily or with other consideration. This is not intended to prevent committee members from receiving travel expense reimbursements for participating in meetings or meals furnished at meetings.
6. Each ARCC member will be financially literate. Financial literacy is defined as being able to read and understand fundamental financial statements. If possible, at least one member should be a "financial expert." This is defined as a person who has an understanding of generally accepted accounting principles and financial statements, the ability to assess the application of these principles, an understanding of ARCC functions, experience preparing, auditing, analyzing or evaluating financial statements, or experience supervising persons engaged in such activities and an understanding of internal controls and procedures for financial reporting.

IV. MEETINGS

1. The ARCC will meet at least four times a year, with authority to convene additional meetings as circumstances require.
2. All ARCC members are expected to attend each meeting in person or via teleconference or videoconference.
3. A majority of the voting members of the committee will constitute a quorum.
4. The ARCC will invite members of management, auditors, risk and compliance managers, or others to attend meetings and provide pertinent information as necessary.
5. The ARCC will hold private meetings with internal and external auditors and executive sessions. If the internal or external auditors request a meeting, the committee is required to meet as promptly as possible.
6. Meeting agendas will be prepared by UNCSA staff and provided in advance to the committee members, along with the appropriate briefing materials.
7. The committee shall maintain written minutes of its meetings.

V. RESPONSIBILITIES

With regards to each topic listed below, the ARCC will:

Financial Statements

1. Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and understand their impact on the financial statements.
2. Review with management and the external auditors the results of the audit, including any difficulties encountered.
3. Review the annual financial statements and other sections of the annual report and related regulatory filings.
4. Review with management and the external auditors all matters required to be communicated to the committee under auditing standards.
5. Understand how management develops financial information, and the nature and extent of internal and external auditor involvement.

Internal Control

1. Review the effectiveness of the internal control system, including information technology security and control, through activities of the internal and external auditors.
2. Understand the scope of internal and external auditor's reviews of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.

3. Determine whether recommendations made by the internal and external auditors have been implemented by management.

Internal Audit

1. Review with management and the CAO the charter, activities, staffing, and organizational structure of the internal audit function. Consider and review any changes to the scope of the internal audit charter. Provided the CAO has responsibilities for risk and compliance functions, ensure there are safeguards in place to limit impairments to independence or objectivity.
2. Have final authority to review and approve the annual audit plan, the internal audit budget and resource plan, and all major changes to the plans.
3. Ensure there are no unjustified restrictions, limitations, or interferences, and review and concur in the appointment, compensation, replacement, or dismissal of the CAO.
4. Review the effectiveness of the internal audit function, including compliance with The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing.*
5. On a regular basis, meet separately with the CAO to discuss any matters that the committee or internal auditing believes should be discussed privately.

External Audit

1. Review the external auditors' proposed audit scope and approach.
2. Review the performance of the external auditors and exercise final approval on their appointment or discharge.
3. On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.

Compliance

1. The ARCC, through the Chancellor, his designee, or the CAO, shall receive reports from management and the organization's legal counsel regarding compliance matters institution-wide, including, but not limited to, the following areas: environmental health and safety, diversity and affirmative action, contracts and grants, and financial aid.
2. Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of noncompliance.
3. Review the findings of any examinations by regulatory agencies and any auditor observations.
4. Review the process for communicating the code of conduct to the organization's personnel and for monitoring compliance therewith.

Risk Management

1. The ARCC is responsible for oversight of the processes to identify, assess, prioritize, and manage general business risks. This includes the current risk environment, emerging risks, and the interrelationship between risks and the context of the university's risk appetite.
2. Receive reports from management regarding the risk environment for UNCSA and ensure that management's responses to significant risks are appropriate, and that resources to address high priority risks are allocated appropriately.
3. Monitor and evaluate guidelines and policies to govern the process by which risk assessment and management is undertaken.

Information Governance and Security

1. Ensure that information governance and security is addressed in the annual audit planning and risk assessments that are conducted by the institution's internal auditor.
2. Periodically include an agenda item for emerging information governance and security matters at its regularly scheduled meetings.

3. Receive a report at least annually from the appropriate senior officer on the institution's information governance and security infrastructure and information technology security controls.

Reporting

1. Regularly report to the Board of Trustees about committee activities, issues, and related recommendations.
2. Provide an open avenue of communication among internal auditing, the external auditors, risk and compliance managers, and the Board of Trustees.
3. Report annually to the UNC Board of Governors, describing the ARCC's composition, responsibilities and how they were discharged, and any other information required.
4. Review any other reports issued by the organization that relate to the ARCC's responsibilities.

Complaints and Ethics

1. Ensure policies and procedures are established to allow employees to report alleged improper activities.

Other Responsibilities

1. Review and assess the adequacy of the ARCC charter annually, requesting board approval for updates of its charter, as necessary.
2. Perform other activities related to this charter as requested by the Board of Trustees.
3. Institute and oversee special investigations as needed.
4. Evaluate the ARCC's and individual members' performance on a regular basis.
5. Consult with UNCSA legal counsel to review any legal matters that may have a significant financial impact.
6. Ensure the internal auditors receive continuing education annually.
7. Ensure the internal auditors participate in the University of North Carolina Auditors' Association, the Institute of Internal Auditors, and other professional organizations in order to stay updated on professional standards, developments with audit, risk, and compliance procedures and other relevant issues.

Effective Date: This Charter becomes effective upon adoption by the Board of Trustees.

Adopted: This the 9th day of February 2018

Michael D. Tiemann
Chair, Board of Trustees
UNC School of the Arts

Stephen R. Berlin
Chair, Audit, Risk, and Compliance Committee
UNC School of the Arts