

September 18, 2018

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 Henry, Chief Audit, Risk, and Compliance Officer
David Harrison, General Counsel
Jim DeCristo, Vice Chancellor for Economic Development and Chief of Staff
Michael Smith, Vice Chancellor for Finance and Administration
Lisa McClinton, Associate Vice Chancellor for Finance and Controller
Amanda Balwah, Secretary of the University
Michael Dodds, Faculty Council Representative
Martha Golden, Faculty Council Representative
Sharon Fogarty, Staff Council Representative
Cindy Liberty, Foundation Liaison

AGENDA

OPEN SESSION

1. Call to Order and Confirm Quorum.....Chairman Berlin
2. Approval of Minutes from the April 24, 2018 Meeting.....Chairman Berlin
3. Enterprise Risk Management:.....Shannon Henry & Jim DeCristo
 - a. Review and Approval of Risk Appetite Statement
 - b. Discussion of Risk Priorities for 2018-2019
4. Matters of Governance and Compliance.....Shannon Henry
 - a. Information Governance and Security.....Greg Gleghorn, Director of Information Security

5. Discussion of External Audits & Reviews (if any).....S. Henry & UNCSA Management

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

6. Discussion of Internal Audit's Reports, Open Projects, and Plans.....Internal Audit Staff
 - a. Activity Summaries and Reports*
 - b. Annual Risk Assessment and Updated Internal Audit Plan*
 - c. 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

7. Approval of Minutes from the April 24, 2018 Meeting.....Chairman Berlin
8. Discussion of Special Reviews and Investigations (*if any*).....Internal Audit Staff

OPEN SESSION

9. Other Business.....Committee Members & Staff
10. Adjourn.....Chairman Berlin

DRAFT OPEN MINUTES

April 24, 2018

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

TRUSTEES PRESENT

Steve Berlin (Chair)*, Pete Brunstetter*, Anna Folwell (phone)*, Rob King (phone)*, Michael Tiemann (ex officio)*

*denotes voting member

COMMITTEE STAFF PRESENT

Shannon Henry (Chief Audit, Risk, and Compliance Officer), David Harrison (General Counsel), Amanda Balwah (Secretary of the University), Martha Golden (Faculty Council Representative), Cindy Liberty (Foundation Liaison)

OTHERS PRESENT

Rod Isom (Internal Audit Manager), Pilar Horne-Davis (Internal Auditor), Devin Doss (Internal Auditor), Lisa McClinton (Controller), Claire Machamer (Chief Technology Officer), Greg Gleghorn, (Director of Information Security), Jim DeCristo (Chief of Staff)

CONVENE MEETING AND CONFIRM QUORUM

Committee Chair Steve Berlin convened the Open Session of the University of North Carolina School of the Arts Audit Committee at 4:00 p.m. A quorum was confirmed.

APPROVAL OF MINUTES

MOTION: Pete Brunstetter moved to approve the minutes from the February 6, 2018 meeting. Rob King seconded and the minutes were unanimously approved.

ENTERPRISE RISK MANAGEMENT (ERM) AND COMPLIANCE

Shannon Henry, Chief Audit, Risk, and Compliance Officer, and Jim DeCristo, Chief of Staff, led a discussion about the status of ERM on UNCOSA's campus.

- NC State's Poole College of Management conducted an enterprise-wide risk assessment for UNCOSA and reported the results of their assessment to UNCOSA management on April 23, 2018.
 - The assessment examined and ranked 25 different areas of risk.

- The steering committee will begin examining the assessment over the next few months to determine the risk areas the university should focus on as it implements its new ERM program.

MATTERS OF GOVERNANCE AND COMPLIANCE

Claire Machamer, Chief Technology Officer, and Greg Gleghorn, Director of Information Security, gave an information governance and security update:

- The Board of Governors introduced two new policies: The Information Technology Governance Policy and the User Identity Access Control Policy.
 - The Information Technology Governance Policy mandates that each UNC constituent institution develop its own information governance program consistent with the UNC System's information technology governance framework and program.
 - The User Identity Access Control Policy requires UNC constituent institutions to put in place controls that protect university data by employing identity confirmations and access control techniques that decrease the likelihood of authorized system access.
- UNCSA Information Security Program Progress
 - A data matrix has been established to identify different information sources, location of data, information classification, data owners, data custodians, current access controls, types of information, and compliance.
 - The following tasks are currently in progress:
 - UNCSA initiated a proof of concept for multi-factor authentication with a vendor (Duo). The pilot group consists of employees from Finance, Admissions, and Health Services.
 - 14 ISO 27002 compliant policies have been submitted for review. Policies will be edited and presented to Cabinet for approval by the end of June.
 - Gap and Crosswalk Analysis is being used to address all of the 14 ISO 27002 policies, as well as the 114 sub-controls. The process addresses how they are mapped to current compliance regulations and current risk assessment score; this is nearing completion. The analysis will identify current gaps in our information security program and architecture.
 - Students have been identified that will fall under the European Union's new General Data Protection Regulation (GDPR). UNCSA is in the process of evaluating existing controls and requesting guidance from Ellucian for additional controls needed to maintain compliance.
 - UNCSA purchased Next Generation Firewall; the installation date is set for May 2018.

DISCUSSIONS OF INTERNAL AUDIT'S REPORTS, OPEN PROJECTS, AND PLANS

Cash Count & Receipting Follow-Up Review

Rod Isom, the Internal Audit Manager, reported that Internal Audit's review revealed no new issues. Of the four outstanding issues, management resolved three and accepted

the remaining risk related to centralizing campus cash. The report provided 1 new recommendation to management related to its acceptance of risk.

Special Review – Contract Compliance

Mr. Isom reported that two observations were reported related to the university's contract compliance. The first was related to weaknesses in the authorization and review of contracts. *Management addressed this issue during the course of the review.* The second observation was related to the appearance of a conflict of interest in the purchasing process. The report provided four recommendations for corrective actions.

Human Resources

Internal Audit's review of the control environment is underway. A survey has been sent to the campus community. The response rate has been high.

CLOSED SESSION

MOTION: Pete Brunstetter 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. Rob King 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 4:36 p.m.

Respectfully submitted by:
Amanda G. Balwah
Assistant Secretary to the Board of Trustees

AGENDA ITEM

Enterprise Risk Management.....presented by Jim DeCristo & Shannon Henry

I. Risk Appetite Statement

Summary: The University's Risk Appetite has been drafted for review and approval by the UNCSA Chancellor and Board of Trustees. The Risk Appetite Statement is a guide to assist with decisions about which goals or operational tactics to pursue. It assists the university with prioritizing actions in those areas where risk is deemed to exceed the defined appetite, therefore ensuring better-informed business decisions are made.

Action: This agenda item requires board approval.

II. Risk Priorities for 2018-2019

Summary: The Enterprise Risk Management Steering Committee has identified four risks that are priorities for the 2018-2019 academic year. These risks will be thoroughly examined, evaluated, and mitigated throughout the year, with regular reporting to the Board of Trustees through the Audit, Risk, and Compliance Committee. UNCSA's top risks were identified in the Enterprise-Wide Risk Analysis conducted by graduate students from NC State's Poole College of Management.

Action: This agenda item is for informational purposes only.

The logo for the University of North Carolina School of the Arts, featuring the text "UNIVERSITY OF NORTH CAROLINA" in a smaller font above "SCHOOL OF THE ARTS" in a larger, bold font, all contained within a dark rectangular background.

UNIVERSITY OF NORTH CAROLINA
SCHOOL OF THE ARTS

Enterprise Risk Management

Risk Statement

In the increasingly complex world of higher education and arts conservatory training, a focus on mission is essential to sifting through the clutter and aligning resources to make sure the mission, and its attending organizational objectives, are supported. The University of North Carolina School of the Arts' (UNCSA) Enterprise Risk Management (ERM) program is the means to identifying, analyzing, and treating the risks that could prevent UNCSA from achieving its objectives. An enterprise approach to risk supports resiliency, and by quantifying the risks of decisions and assessing their most probable paths, it can lead to even greater institutional innovation and agility in responding to opportunities as they emerge.

UNCSA's Mission

UNCSA provides gifted emerging artists with the experience, knowledge, and skills needed to excel in their disciplines and in their lives, and it serves and enriches the cultural and economic prosperity of the people of North Carolina and the nation. UNCSA is the state's unique professional school for the performing, visual, and moving image arts, training students at the high school, undergraduate, and master's levels for professional careers in the arts.

Risk Appetite

UNCSA's administration, faculty, and staff consider the university's risk appetite in both strategic and operational decision-making.

UNCSA's overall appetite for risk is relatively low. However, goals outlined in the strategic plan do necessitate some acceptance of risk that accompanies growth and reward. At times, UNCSA must undertake activities that inherently carry greater risks in order to pursue rewards that will propel the school forward. To that end, UNCSA's risk appetite will often be different at an activity level than at an institutional level.

The key challenges in achieving balance are to ensure:

- ethical and effective governance practices, including responsible stewardship of resources, the realization of opportunities, and allowing innovation while avoiding unnecessary bureaucracy; and
- avoidance of a risk averse culture that can stifle innovation, rather than support it, through the correct assessment and management of risks.

UNCSA's approach is to minimize exposure to risks relating to compliance, environment, culture, and people, all while accepting and encouraging an increased

degree of risk in pursuit of its vision and strategic goals. UNCSCA recognizes that its appetite for risk varies according to the activity undertaken, and that its acceptance of risk is always subject to ensuring potential benefits and risks are fully understood before developments and plans are authorized. The university is committed to establishing sensible measures to mitigate risk where required.

The university's risk appetite across activities is provided in the following illustration and statements below:

	Unacceptable to take risks						Higher willingness to take risks		
	Conservative			Balanced			Entrepreneurial		
Strategic risk							<		>
Financial viability risk					<		>		
Safety and health risk	<		>						
Regulatory and compliance risk	<		>						
Teaching, learning, and research risk					<		>		
Service disruption risk		<		>					
Culture and values risk			<		>				
Environmental & social responsibility risk		<		>					

Strategic risk: Strategic activities are required to develop and expand UNCSCA. The university must adapt to changes in the regulatory and technological environment, as well as in the nature and conduct of the university's activities, programs, and initiatives. In the current strategic plan, UNCSCA aims to:

- Enhance the living and learning environment;
- Launch transformative programs and curricula;
- Foster a quality workplace;
- Be a creative incubator; and
- Catalyze arts-based community and economic development.

Innovative activities and initiatives carry higher risks, but the return is immense as the university follows a strategic plan designed to propel UNCSCA to the forefront of performing arts and media education in the United States. The risk appetite for this area is **entrepreneurial**.

Financial viability risk: UNCSCA aims to maintain its long-term financial viability and overall financial strength, while also recognizing that achievement of its strategic objectives is important to sustain long-term financial viability. There is financial risk associated with strategic growth, which UNCSCA is willing to accept. At the same time, the university will aim to manage financial risk by continuing to abide by the rules and regulations set forth by the State of North Carolina. Overall, UNCSCA's risk appetite in this area tends to be fairly balanced, moving towards **balanced**.

Safety and health risk: UNCOSA strives to make the university a stimulating and safe place to work and study. It places importance on the health and safety of faculty, staff, students, and visitors to the campus, and has no appetite for deviation from the established standards in these areas. Therefore, the risk appetite for this area is **conservative**.

Regulatory and compliance risk: UNCOSA places great importance on compliance, and has no appetite for breaches in statute, regulation, professional standard, nor research. It wishes to maintain accreditation and professional program certification where applicable. The university considers its risk appetite in this area to be **conservative**.

Teaching, learning, and research risk: Two of UNCOSA's strategic goals are to launch transformative programs and curricula, and serve as a creative incubator. Building on the greatest traditions of conservatory education, UNCOSA will leverage contemporary innovations in performance and media to prepare emerging artists who engage new audiences with deeply relevant and outstanding work. The university will also guide and support the development and prototyping of breakthrough artistic works. UNCOSA considers its risk appetite in this area to be **balanced**, but it also realizes an increased risk appetite may be necessary to reach its full potential.

Service disruption risk: It is important to the university that its activities and services operate efficiently and effectively. Therefore, UNCOSA has a limited appetite for any risk that may jeopardize its standards of operation, or that may lead to a loss of confidence and trust by its stakeholders. The risk appetite for this area is relatively **conservative**.

Culture and values risk: UNCOSA aims to support, develop, and utilize the full potential of our faculty and staff to support a culture that prioritizes scholarship, discovery, sustainability, engagement, social justice, citizenry, integrity, collaboration, and creativity. To balance these priorities, the university may need to accept some degree of risk. However, this will be subject to always ensuring that the potential benefits and risks are fully understood before initiatives and projects are authorized so that sensible measures to mitigate unacceptable risk are established. Overall, UNCOSA defines its risk appetite in this area as **balanced**.

Environmental and social responsibility risk: The university aims to make a significant, sustainable, and socially responsible contribution to all the communities within which it operates. Through its strategic plan, UNCOSA is committed to improving the surrounding community in numerous ways, including economically and socially. Community arts outreach is an important part of the university's identity. UNCOSA's overall approach to environmental and social responsibility is **conservative**.

UNCOSA's Strategic Plan: <https://www.uncsa.edu/chancellor/strategic-plan/>

**Enterprise Risk Management
2018-2019 Priorities**

The Enterprise Risk Management Steering Committee has identified four risks that are priorities for the 2018-2019 academic year. These risks will be thoroughly examined, evaluated, and mitigated throughout the year, with regular reporting to the Board of Trustees through the Audit, Risk, and Compliance Committee. UNCOSA's top risks were identified in the Enterprise-Wide Risk Analysis conducted by graduate students from NC State's Poole College of Management. Of the nine risks included in Tier I, the following are priorities for 2018-2019:

Risk 1: Compensation packages offered by UNCOSA may make it increasingly difficult to attract nationally known, top-tier faculty who are needed to maintain the School's national reputation.

Risk owner: Provost and Executive Vice Chancellor (others to be determined)

One of the "crown jewels" that facilitates UNCOSA's success in training young artists is its ability to attract and retain top-level faculty to work with students. Due to competition with other schools and the arts industry, UNCOSA's compensation packages may make it difficult for the School to continue to fill its faculty positions with top-tier talent, which could therefore negatively affect the school's reputation and brand.

Risk 2: Scholarships and financial aid packages offered by UNCOSA may not be sufficiently competitive to attract top student talent, particularly from outside North Carolina.

Risk owners: Vice Provost and Dean of Student Affairs, Vice Chancellor for Advancement, Director Financial Aid, Director of Admissions, Deans

Offerings of scholarships and financial aid packages are an important tool for attracting high-quality students. If UNCOSA is unable to compete with other schools' financial offerings, top-quality student talent may be lost to other schools, adversely affecting UNCOSA's enrollment numbers and the quality of its student body profile.

Risk 4: The condition of facilities and residence halls may decline to the point that it significantly deters students from attending UNCOSA.

Risk owners: Assistant Dean of Student Affairs, Vice Provost and Dean of Student Affairs, Associate Vice Chancellor for Facilities

Although prospective students are primarily focused on the incredible education opportunity offered to them by UNCOSA when evaluating their acceptance decision, the poor condition of residence halls and other facilities may become a significant deterrent in attracting students in the future.

Risk 7: UNCOSA may be unable to attract a sufficiently diverse faculty and student body needed to advance its brand and reputation.

Risk owners: Vice Provost and Dean of Student Affairs, Vice Provost and Dean of Academic Affairs, Provost and Executive Vice Chancellor, Director of Admissions, Student Affairs Staff

The School's current student and faculty demographic make-up does not mirror that of Winston-Salem, North Carolina, or the performing arts industries. As such, pursuing a more diverse faculty and student body is integral to UNCOSA's ability to provide a conservatory model that prepares students to make conscientious contributions to their respective professions. The Schools' efforts to pursue diverse faculty and staff could be hindered by the Schools' current demographic composition, the cultural climate in North Carolina, or the relative underutilization of diverse marketing channels, among other factors.

Determining Priority Risks

While all nine risks in Tier I are very important, the Steering Committee determined the priority risks by completing risk profiles for each that examined the root cause of the risk, both risk and consequence mitigations, additional needs to address the risk, speed of onset, and key risk indicators. Each committee member ranked their priority risks; the top four selected by most became the institutional priorities for the 2018-2019 academic year.

Selection of these priorities will not stop any ongoing risk mitigation efforts or the implementation of new risk mitigation efforts across all areas. UNCOSA remains committed to addressing and minimizing risk as has been the case before this new effort. Our new ERM process will only enhance our efforts and bring more attention and resource to mitigating our risks.

Common Themes

It is important to note that three of the four priority risks (Risks 1, 2, and 4), focus on three pillars of the comprehensive campaign: students, faculty, and living/learning environment. The Steering Committee agrees that it is very important to take a deeper dive into these risk areas by assessing current mitigations and brainstorming new strategies. Mitigating these risks and assessing the consequences will be helpful for fundraising and the overall success of the campaign.

AGENDA ITEM

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

SUMMARY:

The Next Generation Firewall has been installed and is operational; reports generated from Firewall on trends and risks will follow as more data is gathered.

Gap and Crosswalk Analysis is complete. Will transfer current information to UNC Security Council template for delivery no later than September 30th.

In progress

Drafting a Road map for UNCISA Information Security Program addressing the current vs. desired state.

Evaluating Microsoft's Advanced Threat Protection, Multi-Factor Authentication, Data Loss Prevention, Encryption, Anti-phishing Protection, Safe Links and Attachments.

Evaluating Endpoint Security Vendors with Proof of Concept: Carbon Black, CrowdStrike, and McAfee.

Fine Tuning 14 information security ISO 27002 compliant policies prior to submitting for cabinet approval.

Identifying new students and faculty that fall under the EU's GDPR (General Data Protection Regulation).

ACTION: Informational purposes only.

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

Consolidated Financial Statements
Years Ended June 30, 2018 and 2017



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

Consolidated Financial Statements
Years Ended June 30, 2018 and 2017

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

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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 (the "Foundation"), which comprise the consolidated statements of financial position as of June 30, 2018 and 2017, and the related consolidated statements of activities 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, 2018 and 2017, 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 28, 2018

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

Consolidated Statements of Financial Position

June 30, 2018 and 2017

	2018	2017
Assets		
Cash and cash equivalents	\$ 9,878,614	\$ 15,386,660
Investments	44,778,524	36,663,190
Annuity investments	13,685	407,556
Prepaid expenses and other current assets	53,788	59,729
Assets to be transferred to UNCSA	56,222	95,591
Pledges receivable, net	8,776,897	7,791,697
Beneficial interest in perpetual trusts	790,400	760,959
Property	60,001	60,001
Other long-term assets	67,896	77,896
Total assets	\$ 64,476,027	\$ 61,303,279
Liabilities		
Accounts payable and accrued expenses	\$ 27,916	\$ 21,548
Annuity obligations	24,121	47,111
Due to UNCSA	734,056	6,371,150
Total liabilities	786,093	6,439,809
Commitments and contingencies		
Net assets		
Unrestricted:		
Unappropriated	726,200	707,985
Board appropriated	91,731	-
Temporarily restricted	21,595,377	15,502,396
Permanently restricted	41,276,626	38,653,089
Total net assets	63,689,934	54,863,470
Total liabilities and net assets	\$ 64,476,027	\$ 61,303,279

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and support				
Gifts and grants	\$ 557,604	\$ 7,460,472	\$ 2,485,125	\$ 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 long-term assets	-	-	(10,000)	(10,000)
Net gain on other investments reported at fair value	2,915	4,719,824	84,268	4,807,007
Other income	29,043	249,828	-	278,871
Net assets released from restrictions	5,626,216	(5,626,216)	-	-
Total revenue and support	6,307,586	6,814,643	2,612,823	15,735,052
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
Total program services	4,962,509	-	-	4,962,509
Supporting services:				
Development costs	473,409	-	-	473,409
Administrative costs	549,394	-	-	549,394
Investment management fees	212,328	-	-	212,328
Total supporting services	1,235,131	-	-	1,235,131
Total expenditures	6,197,640	-	-	6,197,640
Change in net assets before transfers	109,946	6,814,643	2,612,823	9,537,412
Transfers between funds	-	(10,714)	10,714	-
Transfer of TSKIA funds	-	(654,726)	-	(654,726)
Transfer due to UNCOSA	-	(56,222)	-	(56,222)
Change in net assets	109,946	6,092,981	2,623,537	8,826,464
Net assets, beginning of year	707,985	15,502,396	38,653,089	54,863,470
Net assets, end of year	\$ 817,931	\$ 21,595,377	\$ 41,276,626	\$ 63,689,934

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, 2017

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenue and support				
Gifts and grants	\$ 623,877	\$ 6,999,586	\$ 7,852,314	\$ 15,475,777
Interest and dividend income	906	47,303	-	48,209
Change in fair value of:				
Annuity investments	-	-	39,635	39,635
Perpetual trusts	-	-	8,276	8,276
Annuity obligations	-	-	2,484	2,484
Other long-term assets	-	-	(20,000)	(20,000)
Net gain on other investments reported at fair value	2,979	4,018,503	70,473	4,091,955
Other income	27,405	196,229	-	223,634
Net assets released from restrictions	5,726,086	(5,726,086)	-	-
Total revenue and support	6,381,253	5,535,535	7,953,182	19,869,970
Expenditures				
Program services:				
Scholarships and awards	1,904,587	-	-	1,904,587
School programs	1,647,150	-	-	1,647,150
TSKIA programs	1,642,629	-	-	1,642,629
Total program services	5,194,366	-	-	5,194,366
Supporting services:				
Development costs	382,972	-	-	382,972
Administrative costs	482,030	-	-	482,030
Investment management fees	178,928	-	-	178,928
Total supporting services	1,043,930	-	-	1,043,930
Total expenditures	6,238,296	-	-	6,238,296
Change in net assets before reclassifications and transfers	142,957	5,535,535	7,953,182	13,631,674
Reclassification from agency funds	-	617,095	-	617,095
Transfer between funds	-	(10,728)	10,728	-
Transfers due to UNCOSA	-	(6,295,559)	-	(6,295,559)
Change in net assets	142,957	(153,657)	7,963,910	7,953,210
Net assets, beginning of year	565,028	15,656,053	30,689,179	46,910,260
Net assets, end of year	\$ 707,985	\$ 15,502,396	\$ 38,653,089	\$ 54,863,470

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, 2018 and 2017

	2018	2017
Operating activities		
Change in net assets	\$ 8,826,464	\$ 7,953,210
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Reclassification from agency funds	-	(617,095)
Write-off of pledges receivable	47,743	6,975
Net gain on investments reported at fair value	(4,832,677)	(4,131,590)
Changes in fair value of:		
Perpetual trusts	(29,441)	(8,276)
Other long-term assets	10,000	20,000
Annuity obligations	1,681	(2,484)
Change in operating assets and liabilities:		
Prepaid expenses and other current assets	45,310	(17,554)
Pledges receivable, net	(1,032,943)	(6,494,081)
Accounts payable and accrued expenses	6,368	(2,662)
Due to UNCSA	(5,637,094)	6,200,000
Net cash provided by (used in) operating activities	(2,594,589)	2,906,443
Investing activities		
Purchase of investments, net	(3,308,327)	(194,549)
Transfer from annuity investments	394,870	-
Net cash used in investing activities	(2,913,457)	(194,549)
Change in cash and cash equivalents	(5,508,046)	2,711,894
Cash and cash equivalents, beginning of year	15,386,660	12,674,766
Cash and cash equivalents, end of year	\$ 9,878,614	\$ 15,386,660

See accompanying notes to consolidated financial statements.

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

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” and “UNCSA”). The Foundation is a component unit of the School and is discretely presented in the consolidated financial statements of the School. During 2017, UNCSA Foundation Management, LLC (“UNCSAFM”) was established primarily as 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

Basis of Presentation

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:

- Unrestricted – net assets that are not subject to donor-imposed stipulations.
- Temporarily restricted – net assets subject to donor-imposed stipulations that may or will be met either by actions of the Foundation and/or passage of time.
- Permanently restricted – net assets subject to donor-imposed stipulations that they 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.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Expirations of temporary 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.

Gains and losses on perpetual trusts held by others and annuity obligations are reported as increases or decreases in permanently restricted net assets.

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.

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

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies (Continued)

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, 2018 and 2017, 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.

Four donors accounted for 85% of gross pledges receivable at June 30, 2018. Two donors accounted for 86% of gross pledges receivable at June 30, 2017. Three donors accounted for 55% of gifts and grants in 2018 and two donors accounted for 65% of gifts and grants in 2017.

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 9, 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 recorded 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.

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

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies (Continued)

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 permanently restricted net assets (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.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by UPMIFA. However, when losses result in the market value of a donor-restricted endowment fund declining below the fair value of the original gift, the difference between market and the gift’s original fair value is reflected within unrestricted net assets. 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 that 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 to a maximum of 6% with a minimum of 3.5% of ending unit value at the calculation date.

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.

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

Notes to Consolidated Financial Statements

2. Summary of Significant Accounting Policies (Concluded)

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.

Concentrations of Credit Risk

Risks associated with cash balances are mitigated by banking with credit worthy institutions.

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 permanently restricted.

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.

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 2015; however, no examinations are in process.

Reclassifications

Certain prior year balances have been reclassified to conform to the current year presentation. These reclassifications had no effect on the change in net assets or total net assets previously reported.

Subsequent Events

Management has evaluated events occurring subsequent to the consolidated statement of financial position date through August 28, 2018, 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.

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

Notes to 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 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.

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

	Level 1	Level 2	Level 3	Total
Assets:				
UNC Investment Fund II, LLC	\$ -	\$ -	\$ 44,778,524	\$ 44,778,524
Mutual funds	13,685	-	-	13,685
Total assets at fair value	\$ 13,685	\$ -	\$ 44,778,524	\$ 44,792,209
Liabilities:				
Annuity obligations	\$ -	\$ -	\$ 24,121	\$ 24,121

The following are the assets and liabilities measured at fair value as of June 30, 2017.

	Level 1	Level 2	Level 3	Total
Assets:				
UNC Investment Fund II, LLC	\$ -	\$ -	\$ 36,663,190	\$ 36,663,190
Mutual funds	407,556	-	-	407,556
Total assets at fair value	\$ 407,556	\$ -	\$ 36,663,190	\$ 37,070,746
Liabilities:				
Annuity obligations	\$ -	\$ -	\$ 47,111	\$ 47,111

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

Notes to Consolidated Financial Statements

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

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

<i>June 30,</i>	2018	2017
Balance, beginning of year	\$36,663,190	\$ 32,376,686
Realized and unrealized gains, net	4,807,007	4,091,955
Investment management fees	(212,328)	(178,928)
Transfers in	5,045,319	1,827,955
Transfers out	(1,524,664)	(1,454,478)
Balance, end of year	\$44,778,524	\$ 36,663,190

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

<i>June 30,</i>	2018	2017
Balance, beginning of year	\$ 47,111	\$ 88,417
Payments to annuitants	(24,831)	(45,406)
Amortization and change in assumptions	1,841	4,100
Balance, end of year	\$ 24,121	\$ 47,111

4. Pledges Receivable, Net

Pledges receivable, net, consist of the following:

<i>June 30,</i>	2018	2017
Due within one year	\$ 1,654,440	\$ 1,147,789
Due in one to five years	7,491,792	7,380,725
Due in more than five years	744,000	769,000
Total unconditional pledges	9,890,232	9,297,514
Less:		
Allowance for uncollectible pledges	(395,696)	(371,901)
Discount to present value – 4.5%	(717,639)	(1,133,916)
	\$ 8,776,897	\$ 7,791,697

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

Notes to Consolidated Financial Statements

5. Property

Property consists of the following:

<i>June 30,</i>	2018	2017
Land	\$ 60,000	\$ 60,000
Buildings	1	1
	\$ 60,001	\$ 60,001

6. Restrictions on Net Assets

Temporarily restricted net assets are available for the following purposes:

<i>June 30,</i>	2018	2017
School programs	\$11,000,736	\$ 7,973,178
Unallocated gains on donor-restricted endowments	10,594,641	7,529,218
	\$21,595,377	\$ 15,502,396

Permanently restricted net assets consist of the following:

<i>June 30,</i>	2018	2017
Permanent endowment funds	\$40,428,766	\$ 37,453,790
Annuity and other split-interest agreements	57,460	438,340
Interests in perpetual trusts held by others	790,400	760,959
	\$41,276,626	\$ 38,653,089

7. Endowment Net Assets

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

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets (deficit), beginning of year	\$ (2,230)	\$ 7,529,218	\$ 37,453,790	\$ 44,980,778
Gifts and grants	-	-	2,485,125	2,485,125
Realized and unrealized gains, net	2,915	4,719,824	84,268	4,807,007
Investment management fees	(212,328)	-	-	(212,328)
Amounts appropriated for expenditure, reclassifications and transfers	211,069	(1,654,401)	405,584	(1,037,748)
Endowment net assets (deficit), end of year	\$ (574)	\$ 10,594,641	\$ 40,428,767	\$ 51,022,834

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

Notes to Consolidated Financial Statements

7. Endowment Net Assets (Concluded)

Changes in endowment net assets during the year ended June 30, 2017 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets (deficit), beginning of year	\$ (66,011)	\$ 5,133,151	\$ 29,520,275	\$ 34,587,415
Gifts and grants	-	-	7,852,314	7,852,314
Realized and unrealized gains, net	2,979	4,018,503	70,473	4,091,955
Investment management fees	(178,928)	-	-	(178,928)
Amounts appropriated for expenditure, reclassifications and transfers	239,730	(1,622,436)	10,728	(1,371,978)
Endowment net assets (deficit), end of year	\$ (2,230)	\$ 7,529,218	\$ 37,453,790	\$ 44,980,778

8. Kenan Funds

During fiscal 2017 and 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 have been transferred subsequent to year end.

At June 30, 2018 and 2017, amounts due to UNCSA include approximately \$0 and \$41,000 due to the School for TSKIA-related salaries.

9. Related Party Transactions

Reimbursements to the School for school employees assigned to the Foundation amounted to approximately \$274,000 and \$191,000 in 2018 and 2017. Reimbursements to the School for school employee supplements amounted to approximately \$381,000 and \$195,000 in 2018 and 2017. The School also provides the Foundation with various services, including office space, technology and legal services. In fiscal 2018 and 2017, the Foundation recorded expenses of approximately \$7,900 and \$11,400 for services provided by employees of the School and also other income for the same amount.

At June 30, 2018, approximately \$734,000 is due to the School, which includes approximately \$655,000 related to TSKIA funds (Note 8), as well as equipment and miscellaneous reimbursements. Reimbursements for Kenan Institute employees paid by the Foundation, which are funded by a Kenan grant, amounted to approximately \$452,500 and \$491,800 in 2018 and 2017.

At June 30, 2017, approximately \$6,371,000 is due to the School, which comprises amounts received from donors with instructions to remit these to the School, equipment and miscellaneous reimbursements.

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

Notes to Consolidated Financial Statements

10. Commitments and Contingencies

Retirement Plan

The Foundation contributes to a retirement account a percentage based on its employee's salary. Contributions amounted to approximately \$11,200 and \$7,600 in 2018 and 2017.

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 property on its consolidated statements of financial position at \$1.

11. Recent Accounting Pronouncements

In June 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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. For the Foundation, the ASU is effective for periods beginning after June 15, 2018, with early adoption permitted. Management is assessing the impact of this guidance on the Foundation's future consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*, which reduces the number of net asset classes presented from three to two and requires increased disclosures on liquidity and the use of funds. The ASU is effective for annual financial statements issued for fiscal years beginning after December 15, 2017, with early application permitted. Management is assessing the impact of this guidance on the Foundation's future consolidated financial statements.

In August 2016, the 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 May 2014, the 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 no early application permitted. Management is assessing the impact this guidance may have on the Foundation's future consolidated financial statements.

AGENDA ITEM

Internal Audit Activity Update..... *presented by Shannon Henry & Rod Isom*

Summary:

1. Internal Audit Reports**
 - CDI Review – Internal Controls
 - Subsequent to Internal Audit’s investigative review related to missing property at CDI, an evaluation of the internal control environment was performed to identify the internal control deficiencies that allowed the removal of items to occur.
 - Observations were noted and will be shared at the meeting.
 - Human Resources – Control Environment Update
 - Internal Audit’s review of Human Resources’ (HR) control environment is underway.
 - Observations from the campus-wide survey were shared with senior management and will be included in the forthcoming report.
2. Other Internal Audit Activity**
 - Risk Monitoring Memos
 - Risk monitoring memos issued for reviews planned during fiscal year 2018 that were either deferred or cancelled to focus on higher priority projects. The purpose is to encourage management to evaluate the area and implement mitigations where necessary.
 - Follow-up Memos
 - A request for actions taken to address findings sent for a response.
 - Follow-ups will be conducted accordingly.
3. 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.
4. 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 with the responsibility 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.

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 UNCOSA management and free of any relationship that would impair such independence. Members may not receive from UNCOSA 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 UNCOSA 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 UNCOSA 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 UNCSCA 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

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