

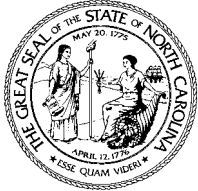
STATE OF NORTH CAROLINA

AUDIT RESULTS FROM
CAFR AND SINGLE AUDIT PROCEDURES
DEPARTMENT OF PUBLIC INSTRUCTION
FOR THE YEAR ENDED JUNE 30, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR



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February 28, 2003

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
The Honorable Michael E. Ward, State Superintendent
Department of Public Instruction

We have completed certain audit procedures at the Department of Public Instruction related to the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*, for the year ended June 30, 2002. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

The results of these procedures, as described below, yielded audit findings and recommendations for the Department related to the State's financial statements and the State's federal financial assistance programs which may require disclosure in the aforementioned reports. We also determined during the current audit a significant deficiency in the management control processes for matters not directly related to financial reporting and federal compliance objectives. The findings noted above are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

Our audit indicates that the financial statements of the Department's General Fund are fairly stated. Additionally, our audit disclosed an internal control weakness affecting cash management of several major federal programs and a management control issue related to a decision not to recoup erroneously paid teacher bonuses.

The accounts and operations of the Department of Public Instruction are an integral part of the State's reporting entity represented in the *CAFR* and the *Single Audit Report*. In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the results of tests on the State's internal control and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget Circular A-133.

As part of the work necessary for issuance of the *CAFR* and the *Single Audit Report*, the following individual funds and federal programs of the State were subjected to audit procedures at the Department of Public Instruction, as we considered necessary:

Funds for the *Comprehensive Annual Financial Report*:

General Fund

Federal Programs for the *Single Audit Report*:

Child Nutrition Cluster:

School Breakfast Program

National School Lunch Program

Special Milk Program for Children

Special Education Cluster:

Special Education – Grants to States

Special Education – Preschool Grants

Title I Grants to Local Education Agencies

Class Size Reduction

The individual funds and federal programs subjected to audit at the Department of Public Instruction are substantially less in scope than would be necessary to report on the financial statements that relate solely to the Department or the administration of federal programs by the Department. Therefore, we do not express such conclusions.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Respectfully submitted,



Ralph Campbell, Jr.
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

Current Year Findings and Recommendations - The following findings and recommendations were identified during the current audit and represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, or grants.

1. FEDERAL FUNDS NOT DRAWN IN ACCORDANCE WITH AGREEMENT

The Department of Public Instruction (DPI) did not have adequate internal controls in place to ensure compliance with the federal Cash Management Improvement Act of 1990 (CMIA). Consequently, numerous drawdowns were received from the federal treasury that resulted in excess federal cash balances; however, on other occasions State funds might be used to finance federal expenditures prior to the arrival of federal funds.

Drawdowns were not made in accordance with the agreement between the U.S. Department of the Treasury and the State of North Carolina. Examples of these violations are:

- The School Breakfast Program (CFDA 10.553) maintained excessive balances ranging from \$1,394.98 to \$13,851.46 for numerous days during the State's fiscal year ended June 30, 2002. Also, from December 4, 2001 to February 11, 2002 this program temporarily expended \$9,393.45 in State funds in lieu of federal funds.
- The National School Lunch Program (CFDA 10.555) maintained excessive balances ranging from \$976.22 to \$58,275.56 for numerous days during the State's fiscal year ended June 30, 2002. Also, from November 30, 2001 to February 11, 2002 this program temporarily expended State funds ranging from \$16,332.44 to \$22,293.44 in lieu of federal funds.

The CMIA agreement requires that program costs be funded on a pre-issuance basis, but funds should not be drawn down more than two business days prior to the day corresponding disbursements are made. The agreement also requires that requests for funds be no more than the amount the State expects to disburse. Section 3 of the *State Cash Management Manual* requires federal funds to be requested in advance of the associated disbursements unless the federal program is required by law to operate on a reimbursement basis.

Recommendation: The Department should have in place appropriate internal control procedures that ensure compliance with the CMIA Agreement.

Agency's Response: We are in agreement with the audit finding. To prevent future occurrences we have already implemented the following corrective actions: (1) Federal cash drawdown requests will be based solely on current cash balances and expenditure needs as posted to the Department's main accounting system; (2) all cash drawdown requests will be reviewed and verified by a second accountant prior to being submitted;

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

(3) cash deposits and expenditure activity will be posted to the reports required by the Cash Management Improvement Act (CMIA) on a daily basis; and (4) the deposits and expenditures posted to these CMIA reports will be reconciled to the Department's main accounting system on a monthly basis.

Matters Not Related to Financial Reporting or Federal Compliance Objectives

Management Control Findings and Recommendations - The following findings and recommendations were identified during the current audit and represent significant deficiencies in the management control processes for matters not directly related to financial reporting or federal compliance objectives.

2. TEACHERS NOT REQUIRED TO REFUND ERRONEOUS BONUSES

Approximately 650 teachers at 43 schools received bonuses of 775,605.28, for which they did not qualify. The Department of Public Instruction in consultation with the Office of State Budget and Management decided not to require teachers to return the erroneous bonuses.

The 2001 General Assembly (Senate Bill 1005) appropriated \$1.5 million to provide bonuses to teachers certified in the fields of mathematics, science, or special education at middle and high schools, when 80% or more of the students are eligible for free or reduced lunch; or when 50% or more of the students are performing below grade level in Algebra I and Biology. The annual bonuses of up to \$1800, some prorated based on areas of responsibility, were to be paid monthly with matching benefits.

In October 2001 the Department's School Business Division created a list of schools eligible for bonuses. Later, in April 2002 the Division reviewed the October 2001 list and determined that the wrong data was used when identifying eligible schools. Performance Composite testing data was used rather than individual Algebra I and Biology testing data. The corrected data resulted in 43 schools originally determined as eligible as, in fact, being ineligible to receive the bonuses. Further, the corrected data resulted in 29 schools that were originally determined as ineligible were, in fact, eligible. Reversions from local educational agencies were used to fund the remaining eligible teacher bonuses.

Recommendation: The Department should recover the payments made in error so that all bonuses are made in accordance with the law.

Agency's Response: We agree with the audit finding. However, we respectfully disagree with the recommendation that "the Department should recover the payments made in error so that all bonuses are made in accordance with the law." As stated in the audit finding, DPI consulted with the Office of State Budget and Management on the initial decision not to require teachers to return the erroneous bonuses. We still believe that was the correct decision under the circumstances. The teachers were not aware that they did not qualify for these bonuses; they received them in "good faith." Therefore, we believe it would be counterproductive to public school education in North Carolina to recover these funds, especially after so much time has passed. We also feel it would be inappropriate to place undue financial hardship on these teachers for an error made by the State.

DISTRIBUTION OF AUDIT REPORT

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

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March 4, 2003

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