



STATE OF NORTH CAROLINA

DEPARTMENT OF COMMERCE

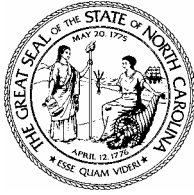
STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

March 29, 2006

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. James Fain, III, Secretary
Department of Commerce

We have completed certain audit procedures at the Department of Commerce related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2005. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements and to its federal financial assistance programs. Our 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 the Single Audit Act as applicable. Our audit scope at the Department of Commerce included the following:

State of North Carolina's Financial Statements

None

State of North Carolina's Administration of Federal Financial Assistance Programs

Community Development Block Grants/State's Program

Workforce Investment Act – Adult Program

Workforce Investment Act – Youth Activities

Workforce Investment Act – Dislocated Workers

Our audit procedures at the Department of Commerce were less in scope than would be necessary to report on the financial statements that relate solely to the Department or its administration of federal programs. Therefore, we do not express such conclusions.

The results of our audit procedures yielded audit findings and recommendations for the Department related to the State's federal financial assistance programs that may require disclosure in the aforementioned reports.

These findings are included in the audit findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding

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

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Finding numbers 1, 2, and 5 were also reported in the prior year.

1. ERRONEOUS AMOUNTS REPORTED ON THE PERFORMANCE AND EVALUATION REPORT

As in previous years, errors were noted in the Performance and Evaluation Report (PER) submitted by the Division of Community Assistance for the Community Development Block Grants (CDBG) program. Such errors may reduce the usefulness of the data to federal funding sources. The following errors were noted in the PER for the year ended December 31, 2004 that was submitted March 31, 2005.

- The “Amount Obligated to Recipients” exceeded the amounts “Allocated” for the 2001 and 2002 grant years. For grant year 2001, the excess amount was \$5,915,540 and for grant year 2002, the excess amount was \$2,874,184. The report’s instructions state that the amount obligated for a grant year should be less than or equal to the amount allocated. The Division recognized that this was a problem and made notations on the report explaining that the amounts obligated for 2001 included projects that should have been reported in 2000 and the amounts obligated for 2002 included projects that were funded by a different funding source. No specific projects were identified and the Division noted that efforts were being made to identify the differences;
- Program Income for grant years 1998 and 1999 was reported as \$0, resulting in an over obligation amount of \$475,696 for the 1998 grant award. In addition the cash draws reported for 1998 exceeded the allocation amount by \$203,063. The cumulative amount of program income should be reported, not just the current year total;
- Our test of 60 individual project awards revealed that the supporting documentation for two awards did not agree with the amounts reported on the PER. The differences were \$5,000 and \$105,000, respectively. Additional tests revealed that the amounts reported were correct but the funding approvals in the files had not been updated.

The Division filed a revised PER on December 28, 2005. The amounts reported were not changed but the Division added additional explanations for the discrepancies. The specific differences still have not been identified.

Recommendation: The Division of Community Assistance should continue in its efforts to review the projects that are being reported and to identify the projects that are not being

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

reported correctly. Changes should be made to the database so that these projects will be reported correctly.

Agency Response:

- As stated, the Division recognizes the error and is in the process of identifying all affected grants and crediting those grants to the proper award year as required by PER guidelines. Once all grants have been properly identified and noted, the Division will conduct a monthly reconciliation of financial data. In addition, the Division will investigate the possibilities of creating through re-organization a Community Development Specialist position that will report to the Division Director. Subject to funding availability, this position will review internal operations on an on-going basis in order to minimize noncompliance errors.
- The Division recognizes this error and filed a revised PER on December 28, 2005 annotating the error and identifying the correct Program Income amounts. As stated above, the Division will investigate the possibility of creating a Community Development Specialist position through re-organization. This potential position will review reconciliation procedures to ensure PER accuracy.
- The funding approvals for the projects mentioned have been properly amended. The Division will implement additional reviews and protocols to ensure that when an award is made a dual check review will be required that verifies the correct funding approval amounts prior to document execution. In addition, any changes that affect the originally approved grant record or any grants in close-out will be reconciled with financial and grant databases to verify data correctness and authenticate accuracy prior to approval of grant changes or close out.

2. MONITORING PROCEDURES WERE NOT PERFORMED TIMELY

The Division of Community Assistance did not ensure that each project in the Community Development Block Grant program received a monitoring visit or was closed out timely. Federal regulations require on-site reviews of units of local government as necessary to determine whether the subrecipient has carried out activities in accordance with Title I of the Housing and Community Development Act of 1974 and with other applicable laws.

Our tests of a sample of 36 subrecipients found that three had not received a monitoring visit. For the instances noted, two subrecipients had requisitioned and received 100% of awarded funds in May 2004, and another had requisitioned and received 97% of its funding in August 2003. These projects received \$75,000, \$350,000, and \$340,000 in grant funds respectively. In addition, these projects had not been closed out.

Without monitoring, the Division cannot be assured that the subrecipient complied with all program requirements.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Recommendation: The Division of Community Assistance should take greater care to ensure that monitoring procedures are performed and reevaluate the system used to determine the projects that need monitoring and closeouts.

Agency Response: The grants in question have been monitored. Effective immediately, Division staff will review all open grants to determine monitoring status. Monitoring priority will be based on funds expended and length of time open. In addition, the Grants Management Section Chief will review monitoring visit statistics weekly and report monthly to management. Also, additional tracking systems will be developed and used to ensure monitoring and close out is conducted timely.

3. PROGRAM CHANGE CONTROLS NEED TO BE IMPLEMENTED

The Division of Community Assistance did not have controls in place over program changes in the Grants Management System (GMS). The GMS is used to prepare and generate the Performance and Evaluation Report (PER). If program modifications are required, the programmer makes the changes and also places them into production. There are no program change review procedures in place to prohibit the programmer from entering unauthorized transactions and making modifications at any time during the year that could alter the program from its original intent.

This condition is a violation of Information Technology System (ITS) security policy which states “all information technology services and systems must address the security implications of any changes made to a particular service or system. The agencies must authorize all changes. Agencies should ensure that proper change control procedures are in place for promoting program changes to authorized status.”

Recommendation: The Division should implement controls to ensure adequate supporting documentation is maintained for the modification and implementation of all program changes. Further, the Division should implement internal control procedures to ensure that the programmer does not have the ability to place program changes into production without authorization. This will provide reasonable assurance that only authorized transactions are entered into the system. In addition, the Division should review ITS security policy to ensure compliance with security rules and program data changes for the system.

Agency Response: In consultation with the Division of Management Information Systems, we are in the process of developing a Program Change Request (PCR) document that will be used to formalize the software change activities within the Division of Community Assistance. The PCR document will be used to initiate, describe and approve program modifications to the Grants Management System. In addition, the Department will develop and implement a Program Change Log document and a formal policy that will identify the basic requirements that must be addressed when changing production software or data stores

4. UNNECESSARY COSTS CHARGED TO THE WORKFORCE INVESTMENT ACT PROGRAM

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Complaints were initiated against the Division of Employment and Training by employees of the division that alleged that the division denied them equal opportunities in employment in violation of federal laws. The Department did not admit to violating laws, however, a settlement was reached and two complainants received monetary payments under those settlements during the audit period. These payments totaled \$15,301 in salary and fringe benefits and were paid from the WIA program.

OMB Circular A-87 states that expenditures incurred must be reasonable, necessary and consistent with policies, regulations, and procedures that apply uniformly to both Federal and other activities of the governmental unit. This type cost is not generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award. As a result, we are questioning costs of \$15,301.

Recommendation: The Division should adhere to OMB Circular A-87 and ensure that all charges to federal programs are reasonable and necessary.

Agency Response: The Department of Commerce and the Division of Employment and Training chose to address the four employee grievances through a mediation process to minimize the cost of a potentially long-term process and the negative impact on productivity and morale that long term grievance procedures involving four employees could exert on the Division and the Department. The single case that is still pending has progressed through various stages of the grievance process since November, 2004. Our intent in pursuing the mediated settlements in question was to avoid such circumstances. In seeking to settle the matters through mediation, the Department has acknowledged no wrongdoing. Similarly, the Department does not concur in the employees' allegation that it failed to post a vacancy. That issue is the subject of litigation, the Attorney General's Office is defending the Department's position in the matter, and no final decision has been rendered by a court on that point.

We concur in your recommendation regarding adherence to State personnel rules for posting vacancies, and we will continue to ensure that the prescribed rules are followed when recruiting employees to fill vacant positions.

5. FEDERAL FINANCIAL REPORTS NOT REVIEWED FOR THE WORKFORCE INVESTMENT ACT PROGRAM

In the prior audit we noted the Division of Employment and Training quarterly Financial Status Reports for the Workforce Investment Act (WIA) program were not reviewed and approved by someone independent of the preparer. Management has taken action to correct the weakness; however, the issue continued to exist during a significant portion of the current audit.

This finding is resolved: Management has taken action to address the issue noted above. The quarterly reports were reviewed and approved by someone independent of the preparer for the quarters ended March and June 2005.

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

Telephone: 919/807-7500

Facsimile: 919/807-7647