



STATE OF NORTH CAROLINA

DEPARTMENT OF CRIME CONTROL AND PUBLIC SAFETY

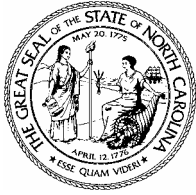
STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



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

April 5, 2006

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. Bryan E. Beatty, Secretary
Department of Crime Control and Public Safety

We have completed certain audit procedures at the Department of Crime Control and Public Safety 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 Crime Control and Public Safety included the following:

State of North Carolina's Financial Statements

None

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

- CFDA 83.544 – Public Assistance Grants – Federal Emergency Management Agency
- CFDA 97.036 – Public Assistance Grants – Department of Homeland Security
- CFDA 97.004 – State Domestic Preparedness Equipment Support Program
- CFDA 97.067 – Homeland Security Grant Program

Our audit procedures at the Department of Crime Control and Public Safety 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 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." with a stylized flourish at the end.

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 significant deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants. Finding numbers 2 and 5 were also reported in the prior year.

1. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS CONTAINED ERRORS

Controls were not in place to ensure that the Schedule of Expenditures of Federal Awards (SEFA) was prepared in accordance with federal requirements. The OMB Circular A-133 requires that the SEFA provide total federal awards expended for each individual federal program. It states that the determination of when an award is expended should be based on when the activity related to the award occurs, such as when the expenditure takes place.

The Public Assistance expenditures were not recorded into the North Carolina Accounting System (NCAS) by CFDA number or funding source. This is a contributing factor to the errors that were made on the Department's SEFA. These errors are described below.

1. The Department reported the amount of federal funds received in the general fund for some cost centers, rather than reporting the actual outlays of federal funds for the Public Assistance Grant. This caused federal expenditures to be overstated by \$718,389;
2. Federal funds expended for the Public Assistance Grant in the special revenue budget code were not included on the SEFA. As a result, the Department understated expenditures by \$23,473,093;
3. Expenditures in four general fund cost centers, which had been identified to us as recording Public Assistance expenditures, were not included on the SEFA. This omission understated expenditures by \$1,335,714. In addition, we noted that no federal funds had been drawn down for these costs during the current year;
4. Expenditures for Public Assistance Grants awarded prior to September 12, 2003 are to be reported under CFDA 83.544. After that date, the expenditures are to be reported under CFDA 97.036. The expenditures were not separated correctly between the two CFDA numbers;
5. The amounts reported on the SEFA exceeded the amount reported on the supporting documentation for the Public Assistance Grant by \$166,264.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

The net effect of the errors noted above caused the Public Assistance Grant expenditures reported under CFDA 83.544 to be understated by \$30,450,298 and the expenditures reported under CFDA 97.036 to be overstated by \$6,526,144.

In addition, the expenditures for the FY 2005 award for the Emergency Management Performance Grants were reported under CFDA 97.042 Emergency Management Performance Grants but should have been reported under CFDA 97.067 Homeland Security Grant Program. Therefore a \$1,188,903 adjustment had to be made for each grant.

A revised SEFA was submitted to the Office of the State Controller, containing corrections for all errors described.

Recommendation: The Department should implement procedures to ensure that the SEFA is prepared in accordance with federal requirements. The Department should continue in its efforts to establish an accounting system that will capture grant transactions in a manner sufficient to readily report the necessary information required on the SEFA. The cost center listing that identifies federal expenditures should be defined and cross matched in a table that is updated monthly by a designee of the Department's Controller's Office. The version maintained by the designee of the Controller's Office should be used by all staff entering accounting information and reporting for the cost centers.

Agency's Response: The Department agrees with this finding.

Corrective Action

Procedures have been implemented to require independent double-checking of calculations and reported amounts prior to submitting the SEFA. Procedures will also require the preparation of a schedule to cross reference costs centers to the most current listing of CFDA numbers. This action will be completed by July 15, 2006.

2. CONTROLS OVER REPORTING FEDERAL DRAWDOWNS NEED IMPROVING

The Department did not have adequate controls to ensure that drawdowns from the Public Assistance Grant were made in accordance with *The Cash Management Improvement Act (CMIA)* Agreement between the State of North Carolina and U.S. Department of Treasury, also known as the Treasury-State Agreement (TSA). There were also many instances where the Department submitted erroneous data regarding federal drawdowns and federal expenditures to the Office of the State Controller (OSC) on the CMIA report. Errors in this data cause OSC's calculation of the State's interest liability to the federal government to be incorrect. Our test and analysis of federal drawdowns revealed the following.

- Federal Funds were erroneously drawn down and not returned in a timely manner. On July 8, 2004, the Department drew down a total of \$1,543,637 in error but actually reported this amount as a deposit and disbursement on the CMIA report. The total amount, which included a state portion of \$373,191, had already been drawn on

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

July 6, 2004. This error was identified in February 2005 and returned to the federal government in March 2005. No corrections were made to the CMIA report to show that the Department had these funds on hand for eight months. This in effect allowed the Department to hold these funds for eight months without incurring an interest liability to the federal government. We calculated this interest liability to be approximately \$24,000;

- The Department's CMIA report did not accurately reflect all federal drawdowns.

The Department's fiscal reports, used by the accountant responsible for drawdowns, showed that a total of \$66.6 million was drawn down for the Public Assistance Grants, but the CMIA report showed a total of \$58.4 million was drawn and disbursed. As a result the CMIA report did not account for \$8.2 million in federal drawdowns and expenditures. Our test of 39 drawdowns revealed 30 specific instances where the Department's accounting records did not agree with the data reported to OSC. For example, on September 21, 2004, and June 9, 2005, the Department's accounting records showed a total deposit and expenditure of \$1,176,917 and \$1,089,998, respectively. However, the Department did not report any deposits and expenditures to OSC for those dates;

- The Agency's CMIA report did not show any cash balance at June 30, 2005; however, the Department's fiscal reports showed a cash balance of \$475,409.

Recommendation: The Department should strengthen internal controls to ensure that drawdowns are made in compliance with the TSA Agreement and that the data submitted to OSC is accurate. Specifically, there should be an independent verification of data recorded on the CMIA report. Employees involved in the federal drawdown process should undergo training that focuses on the application of cost centers, an overview of the CMIA, the TSA and any changes to the required reporting and processing of information for federal programs covered by the CMIA. There should be a monthly reconciliation of federal drawdowns to their related expenditures. The Department should ensure that it fosters a timely and accurate communication with OSC regarding federal drawdowns.

Agency's Response: As stated in the audit finding, the reported drawdown error was disclosed prior to the audit, resulting from reconciliation procedures implemented by the Department. The Department agrees that CMIA reporting needs improvement.

Corrective Action

The importance of accurate and timely CMIA reporting will be reemphasized with all responsible employees. In addition, procedural and personnel changes will be made to strengthen controls in this area. This action will be completed by April 30, 2006.

3. PUBLIC ASSISTANCE FINANCIAL REPORTS ARE INCORRECT DUE TO ERRORS AND OMISSIONS.

Controls were not in place to ensure that amounts reported on the financial reports were accurate and complete. The FEMA 20-10 Financial Status Reports are the reports used

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

to report quarterly and cumulative expenditures for each disaster. Seven of the eight FEMA 20-10 Financial Status Reports tested had errors as described below.

1. Four cost centers were not included on the FEMA 20-10 reports for the quarter ended June 30, 2005. This resulted in \$1,137,000 of federal expenditures not being reported for the quarter ended June 30, 2005;
2. No expenditures were reported for the quarter ended December 31, 2004, for one cost center even though the accounting records reported \$1,177,286 of expenditures for this time period. This resulted in federal expenditures being understated by \$882,964 and state expenditures being understated by \$294,321;
3. The expenditures for one cost center totaling \$87,751 were reported as 100% federal expenditures even though this cost center actually had no expenditures from federal sources;
4. Three FEMA 20-10 Financial Status Reports are filed under the incorrect Catalog of Federal Domestic Assistance (CFDA) number. Hurricane Ivan reports were filed under CFDA 83.544 instead of CFDA 97.036.

The FEMA 20-10 Financial Status reports are the basis for the SF-272 Financial Report; therefore the SF-272 reports are also incorrect.

The FEMA 20-10 requires the reporting of the cumulative program outlays, non-federal outlays and federal outlays for each program. Control procedures should be in place to ensure that amounts reported are accurate and complete.

Recommendations: The cost center listing that identifies federal expenditures should be defined and cross matched in a table that is updated monthly by a designee of the Department's Controller's Office. The version maintained by the designee of the Controller's Office should be used by all staff entering accounting information and reporting for the cost centers. The process for completing reports should be written and staff trained in proper reporting. The reports should be adequately reviewed to ensure accuracy.

Agency's Response: The Department agrees with this finding.

Corrective Action

Documentation currently available and used to cross reference cost centers with respective grants will be summarized in a single table and routinely updated to ensure that it is current. Procedures will also require periodic referencing of published CFDA numbers to ensure that records are updated to reflect any changes. This action will be completed by June 30, 2006.

4. SF-272 REPORTS NOT FILED AND SF-269 REPORTS NOT REVIEWED FOR HOMELAND SECURITY GRANT

The program compliance supplement for the Homeland Security Grant contained in the OMB Circular A-133 Compliance Supplement, states that the SF 272 report is required

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

for this program. The Department contends that this report is not required and consequently did not file any SF-272 Reports for this grant during the audit period.

The Department did submit the required SF-269, Financial Status Reports, on a quarterly basis, but these reports were submitted electronically by the person who prepared them, without having been reviewed for errors and omissions. Supervisory review is a good control to ensure that the financial reports are accurate and complete.

Recommendation: The Department should contact the federal agency to determine if the SF - 272 report is required or if it has been waived. Additionally, the Department should establish procedures to ensure that all filed reports are reviewed for accuracy and agreed to supporting documentation.

Agency's Response: The Department disagrees in part with this finding on the basis that filing SF-272 is not required. All financial reporting guidance provided for Homeland Security grants has excluded any reference to SF-272, and the Department has verified on previous occasions that the SF-272 is not required for this program. Recently, the Department received written correspondence from the Department of Homeland Security stating the following: "Department of Homeland Security grant recipients are not required to submit SF-272s. The statement in the compliance supplement indicating that the SF-272s are required is an error and a request has been made to get this statement corrected." The Department agrees that SF-269 reports did not receive review. The current electronic filing process of SF-269 reports does not allow for supervisory sign off.

Corrective Action

Based on the above information, the audit finding concerning SF-272 does not warrant further action by the Department. The Department is currently examining the electronic filing process to determine a proper approval method. The Department is also consulting the Department of Justice for online approval procedures. This action will be completed by May 31, 2006.

5. INADEQUATE TRACKING OF PUBLIC ASSISTANCE SUBRECIPIENT AUDIT REPORTS

The Department did not have adequate and reliable controls to ensure the tracking and receipt of subrecipient audit reports for the Public Assistance Grants. This condition limits the Department's ability to ensure that funds granted to subrecipients are expended in accordance with grant requirements. OMB Circular A-133 states, in part, that the pass-through entity (the Department) is responsible for ensuring required audits are performed and that the subrecipient takes timely and appropriate corrective action on any audit findings.

During our audit of the Public Assistance Grants program, we identified 11 subrecipients that received \$500,000 or more in Federal funds. We noted that one of the subrecipients was not included on the tracking system and did not receive the required single audit.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Because the subrecipient did not receive the required single audit, the Department was not able to follow-up on any possible audit findings.

The Department has developed a tracking system; however the subrecipient in question was not identified by the system for tracking and follow-up.

Recommendation: The Department should ensure that a tracking system is functioning properly and that all required subrecipient audit reports are received and reviewed in a timely manner.

Agency's Response: In prior years, the Department implemented procedures to improve tracking of subrecipient audit reports; however, we agree that the single exception noted in the audit finding occurred.

Corrective Action

The Department will continue to work towards full compliance and ensure that all required audit reports are received and reviewed. This action will be completed by April 30, 2006.

6. HOMELAND SECURITY GRANT ADMINISTRATIVE COSTS EXCEEDED ALLOWABLE AMOUNTS

The Department did not have controls in place to ensure that the allowance for administrative costs for the Fiscal Year 2003 Part II State Homeland Security Grant Program was not exceeded. According to the North Carolina Emergency Management Allocation Letter dated July 16, 2003, which outlines allotment amounts for this grant, a maximum of \$957,840 may be spent for administrative purposes. Note 1 of this letter also states that "Only 3 percent of the total first responder preparedness allocation may be used for administrative purposes. This amount will be managed by the NC Division of Emergency Management". As of June 30, 2005, accounting records indicated amounts spent for administrative purposes of \$1,128,431. We question cost of \$170,591, which is the amount that the actual administrative costs exceeded the amount allowed.

Recommendation: The Department should institute controls to track administrative amounts on a monthly basis and compare them to allowed amounts to avoid exceeding administrative allocations.

Agency's Response: The Department agrees that administrative costs recorded against this grant exceeded grant limitations. However, amounts allowable for Homeland Security administrative costs have not been exceeded. The Department did not ensure a timely cutoff of charges to the 2003 Part II allocation and start up of assigning those costs to the next fiscal year's allocation of Homeland Security funding. During the audit, the reassignment of the administrative costs was completed.

Corrective Action

Procedures will be implemented to ensure improved monitoring and assignment of administrative costs. This action will be completed by June 30, 2006.

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