



STATE OF NORTH CAROLINA

DEPARTMENT OF CRIME CONTROL AND PUBLIC SAFETY

STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



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March 28, 2007

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, 2006. 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 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." 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 1, 2, 3, 5 and 6 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. Our audit of the agency prepared SEFA revealed a number of errors that are described below.

1. The Department reported total federal expenditures of \$141,393,906 on the SEFA that was submitted with the year-end financial reporting package. Our tests revealed that the federal expenditures reported were understated by \$54,933,530. The primary cause for the difference was the method used by the Department to prepare the SEFA. The Department did not include all federal expenditures in its calculation because it had included only cost centers that contained funds transferred to subrecipients when calculating the federal expenditures. In addition the Public Assistance and Homeland Security expenditures were not recorded into the North Carolina Accounting System (NCAS) by CFDA number or funding source. Since the federal expenditures are not readily identified in the accounting records, extensive research is required to determine the federal expenditures;
2. 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;
3. Homeland Security Cluster and Non Homeland Security Cluster expenditures were comingled under CFDA 97.004;
4. Homeland Security Cluster programs were reported on the SEFA under their legacy CFDA numbers. These funds should have been reported under the CFDA number 97.067.

The net effect of the errors noted above caused the Public Assistance Grant expenditures reported under CFDA 83.544 to be understated by \$27,548,497 and the expenditures reported under CFDA 97.036 to be overstated by \$22,375,455. In addition expenditures

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

of the Homeland Security Cluster reported under CFDA 97.004 were overstated by \$7,467,382 while the expenditures reported under CFDA 97.067 were understated by \$9,895,406. Other nonmajor programs were understated by \$47,332,464.

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: Positions have been established and employees have been hired to provide the resources necessary to ensure accurate and consistent preparation of the SEFA. Full corrective action will be completed by July 30, 2007.

2. FEDERAL FUNDS NOT PROCESSED IN ACCORDANCE WITH AGREEMENT

The Department did not have adequate controls to ensure that drawdowns for the Public Assistance Grant (CFDA 97.036) were processed in accordance with the Cash Management Improvement Act (CMIA) Agreement between the State of North Carolina and the 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.

1. Federal Funds were erroneously drawn down and not returned in a timely manner. For example per the financial records, on June 29, 2006, the Department had drawdowns from the Hurricane Ophelia, (Disaster #1608) in excess of expenditures in the amount of \$1.7 million. The excess funds were not returned to the Federal government until August 2006. Of the overdrawn amount only \$183,551 was shown as an overdraw on the CMIA worksheet. This in effect allowed the Department to hold these funds for one month without incurring an interest liability to the federal government;
2. The Department's CMIA report for CFDA 97.036 did not agree with the Department's financial records. The CMIA reported \$33.9 million in drawdowns and disbursements while the financial records showed federal drawdowns as

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

\$31.8 million. The Department had erroneously included drawdowns for the 2003 Ice Storm on the CMIA report for CFDA 97.036 even though these funds were from CFDA 83.544. As a result the CMIA drawdowns and expenditures were overstated by about \$2.1 million. The Department submitted the erroneous CMIA report to the Office of the State Controller (OSC);

3. There was an erroneous drawdown made on January 25, 2006, in the amount of \$42,902. There was a note on the drawdown documentation stating that these funds should have been returned to the Federal government. This drawdown was returned in August 2006;
4. One draw of \$150,418 that should have been drawn from the Public Assistance grant was mistakenly drawn from the Hazard Mitigation grant in August 2005. The draw was corrected in November 2005 but was not included on the CMIA worksheet;
5. There was no independent review of the drawdown documentation prior to the draws being made to ensure accuracy. In addition, there was no independent verification of the data recorded on the CMIA report.

Recommendation: The Department should strengthen internal controls to ensure that drawdowns are made in compliance with the TSA/CMIA Agreement and the data submitted to OSC is accurate. Specifically, there should be an independent verification of data recorded on the CMIA report.

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

Corrective Action: Controls have been strengthened, positions have been established, and employees have been hired to provide the resources necessary to ensure that drawdowns are accurate and in compliance with the TSA/CMIA. This action will be fully implemented by April 30, 2007.

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

Controls were not in place to ensure the amounts reported on the financial reports were accurate and complete. The FEMA 20-10 Financial Status Reports are the reports used to report quarterly and cumulative expenditures for each disaster. All five FEMA 20-10 Financial Status Reports tested had errors and or omissions as described below.

1. Cost centers that are only reported in the North Carolina Accounting System (NCAS) were not reported in the following FEMA 20-10 reports for the quarter ending June 30, 2006: Hurricane Floyd (Disaster #1292), Ice Storm 03 (Disaster #1457), Hurricane Isabel (Disaster #1490), Hurricane Ivan (Disaster #1553), and Hurricane Ophelia (Disaster #1608). The result was a \$533,005 understatement of federal expenditures and a \$1,222,725 understatement in total outlays;
2. The FEMA 20-10 for Hurricane Floyd (Disaster #1292) was mathematically incorrect. The Federal Share of Outlays line was overstated by \$2,214,250;

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

3. Only the federal expenditures and not the total expenditure amounts were transferred from Public Assistance Management System (PAMS) which is the computer system used to record disaster payments, into NCAS for Ice Storm 03 (Disaster #1457). The result was an understatement in total outlays on the FEMA 20-10 for Ice Storm 03 (Disaster #1457) of \$2,757,624;
4. None of the five FEMA 20-10 reports contained an identifying CFDA number included on the form. Hurricane Floyd (Disaster #1292), and Ice Storm 03 (Disaster #1457) should have been filed under CFDA 83.544, and Hurricane Isabel (Disaster #1490), Hurricane Ivan (Disaster #1553), and Ophelia (Disaster #1608) should have been filed under CFDA 97.036.

The FEMA 20-10 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.

Recommendation: Control procedures should be put in place that ensures the accuracy of the reports. The process of completing reports should be written and staff trained in proper reporting. The reports should be independently reviewed for accuracy.

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

Corrective Action: Corrected financial reports have been prepared and submitted. Employees have been hired to provide the resources necessary to accurately prepare and check financial reports in accordance with established procedures.

4. HOMELAND SECURITY FINANCIAL REPORT IS INCOMPLETE

The SF-269 report for Homeland Security Grant (2005-GE-T5-0051) failed to report the State matching portion of the Recipient Share of Outlays for the quarter ending June 30, 2006. The amount omitted was \$1.4 million.

The Homeland Security Grant Cluster includes an Emergency Management Performance Grant (EMPG) which requires the SF-269 to reflect the amount of recipient outlays.

Recommendation: The Department of Crime Control and Public Safety should review Federal Guidelines before preparing the SF-269 reports to ensure all reporting criteria are met.

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

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Corrective Action: Corrected financial reports have been prepared and submitted. Employees have been hired to provide the resources necessary to accurately prepare and check financial reports in accordance with established procedures.

5. INADEQUATE TRACKING OF PUBLIC ASSISTANCE SUBRECIPIENT AUDIT REPORTS

The Department did not have adequate controls in place to ensure the tracking 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 test of five subrecipients who expended over \$500,000 in Public Assistance funds during the prior year, we found that the Department had not reviewed the audit reports for two subrecipients. These subrecipients' names were included on the Department's tracking system but no information was recorded related to the review of the audit reports. Even though the two subrecipients were included on the tracking system, the Department did not realize that they had received over \$500,000 and did not realize that an audit was required. The Department's tracking system was not based on the underlying accounting records therefore it was unable to identify subrecipients that received \$500,000 or more in Federal Funds.

Although the reports were not tracked/reviewed, both of the mentioned subrecipients did have audits performed and neither had findings related to the Public Assistance grants.

Recommendation: The Department should institute a tracking system that readily identifies subrecipients receiving \$500,000 or more in Federal Funds. The Department should ensure 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 exception noted in the audit finding occurred.

Corrective Action: The Department will continue to work toward full compliance and ensure that all required audit reports are received and reviewed. This action will be completed by April 30, 2007.

6. HOMELAND SECURITY GRANT ADMINISTRATION 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 (Grant No. 2003-MU-T3-0045) State Homeland Security Grant Program was not exceeded. According to the U.S. Department

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

of Homeland Security Program Guidelines and Application Kit no more than 3% of the total amount allocated to the State for each program within Homeland Security Grant Program may be retained at the State level and used for management and administrative costs.

The maximum allowed management and administrative costs for the 2003 part II grant was \$957,840 and our audit discovered that the agency has spent \$978,598. We question cost of \$20,758, 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 the maximum allowable amounts.

Agency's Response: The Department agrees that as of June 30, 2006, reported administrative costs for this grant exceeded grant limitations by \$20,758; however, amounts allowable for administrative costs were not actually exceeded. The Department did not ensure timely recording of accounting entries to correct previously identified errors in the classification of costs.

Corrective Action: Entries have been made to properly classify the identified expenses.

7. DOCUMENTATION NOT MAINTAINED TO IDENTIFY SUBRECIPIENT RESPONSIBILITIES

Documentation was not maintained to identify subrecipient responsibilities. The Public Assistance staff did not maintain files of the State-Applicant Agreement (SAA) that describes the applicant responsibilities for reporting and audit.

Agency records were incomplete for five out of 60 payments recorded in the North Carolina Accounting System tested. The SAA's were missing from the agency file server and could not be located by agency staff. Missing SAA's were from the following disasters, 2002 Ice Storm (Disaster #1448), Hurricane Ivan (Disaster #1553), and Hurricane Ophelia (Disaster # 1608 and 3254).

Agency procedures require that applicants agree to the SAA which contains the agreement between the applicant and the State as it pertains to reporting, monitoring, conformance to State and federal laws and regulations and the need for a OMB Circular A-133 Single Audit.

Recommendation: Agency staff should take extra care to ensure that required documentation is maintained.

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

Corrective Action: The Department will strengthen controls to ensure that procedures designed for maintaining files are followed. This action will be completed by April 30, 2007.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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