



# STATE OF NORTH CAROLINA

**DEPARTMENT OF PUBLIC INSTRUCTION**

**STATEWIDE FINANCIAL AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2007**

**OFFICE OF THE STATE AUDITOR**

**LESLIE W. MERRITT, JR., CPA, CFP**

**STATE AUDITOR**



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March 13, 2008

The Honorable Michael F. Easley, Governor  
Members of the North Carolina General Assembly  
The Honorable Dr. June St. Clair Atkinson, State Superintendent  
Department of Public Instruction

We have completed certain audit procedures at the Department of Public Instruction 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, 2007. 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 Public Instruction included the following:

State of North Carolina's Financial Statements

General Fund

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

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 Educational Agencies

Improving Teacher Quality State Grants

Safe and Drug - Free Schools and Communities State Grants

Our audit procedures at the Department of Public Instruction 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 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 Responses section of this report.

The Department's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. We did not audit the responses, and accordingly, we express no opinion on them.

*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.



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

## AUDIT FINDINGS AND RESPONSES

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### Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings 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.

#### 1. INADEQUATE SUBRECIPIENT MONITORING

The Department did not monitor fiscal matters for subrecipients in the Special Education-Grants to States and Special Education - Preschool Grants programs. As a result, there is an increased risk that unallowable costs at the subrecipient level would not be detected.

The Department monitored subrecipients for specific program performance indicators, such as graduation rate, dropout rate, and statewide assessment, but did not perform any fiscal monitoring to determine that the subrecipient spent the funds for allowable activities. Subrecipients were awarded \$305,945,740 in federal funds during the fiscal year.

OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organization*, requires pass-through entities to monitor the activities of subrecipients as necessary to ensure that federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

This deficiency impacted federal funding periods July 2004 - September 2005 (H027A040092A and H173A040096), July 2005 - September 2006 (H027A050092A and H173A050096), and July 2006 - September 2007 (H027A060092A and H173A060096).

*Recommendation:* The Department should incorporate fiscal monitoring in its program monitoring efforts to provide greater assurance that subrecipients will comply with all federal requirements.

*Agency Response:* Although in 2006-07 DPI did not perform site monitoring visits of recipients in the Special Education - Grants to States and Special Education - Preschool Grants programs, DPI did perform desk reviews of the recipient's annual audit reports, did provide on-site time and effort training, and did review time and effort documentation. As DPI undergoes a redesign of the functions deemed necessary to provide comprehensive support for districts and schools, it is also the intent to establish a more comprehensive monitoring and compliance functional team within the Financial and Business Services Area which will perform fiscal monitoring of all federal programs through periodic site visits in order to provide greater assurance that subrecipients are using Federal awards for authorized purposes in compliance with Federal fiscal requirements.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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### 2. ERRORS IN FEDERAL CASH DRAWDOWN REPORTING

The Department made errors in the Cash Management Improvement Act (CMIA) reports submitted to the Office of State Controller (OSC) for the School Breakfast Program and the National School Lunch Program. As a result, there was an increased risk of error in OSC's calculation of the State's interest liability to the federal government.

Our test of federal drawdowns revealed the following:

- The Department did not record federal drawdowns and expenditures of approximately \$8.9 million in the CMIA report for the National School Lunch Program.
- The Department did not record federal drawdowns and expenditures of approximately \$3.3 million in the CMIA report for the School Breakfast Program. Of this amount, approximately \$2.9 million was recorded in error on the National School Lunch Program CMIA report and approximately \$422,000 was not reported in any CMIA report.
- The Department drew down federal funds in excess of need of approximately \$100,690 for the School Breakfast Program. This amount was offset during the next drawdown. Also, the Department did not initially record this amount in the CMIA report.

The Department did not detect the errors because staff did not perform reconciliations of the CMIA reports to its accounting records in a timely manner. Our test of the monthly reconciliation process revealed that for the last four months of the fiscal year, the reconciliations for the School Breakfast Program and the National School Lunch Program were not performed. After the Department was informed of the errors, it submitted revised CMIA reports that included all omitted drawdowns for the School Breakfast Program and National School Lunch Program to the OSC on December 6, 2007, and also performed fiscal year-end reconciliations.

The cash management agreement between the United States Treasury and the State requires the State to maintain information on disbursements and receipts of funds to verify the implementation of the funding technique and document interest liabilities. Also, prudent internal control requires reconciliation and reviews to ensure accuracy of reports.

This finding impacts federal grant years October 2003 - September 2007 (5NC300327).

*Recommendation:* The Department should strengthen control procedures by reviewing CMIA reports to ensure that they are accurate and complete. Also, the Department should reconcile CMIA reports to its accounting records on a monthly basis and appropriately review and approve monthly reconciliations.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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*Agency Response:* The reports were in error and corrected during the audit. DPI has implemented a procedure whereby the Section Chief will review the CMIA reconciliation each month to insure its accuracy.

### 3. ANNUAL FEDERAL REPORT CONTAINED ERRORS

Child counts included in the Department's "Report of Children and Youth with Disabilities Receiving Special Education Under Part B of the Individuals with Disabilities Education Act" were not supported by underlying documentation. Errors in the report reduce the usefulness of the data to the users.

The report contains an unduplicated count of children with disabilities receiving special education and related services and was submitted to the U.S. Department of Education. Our test revealed numerous differences between the numbers shown in the report and the Department's supporting documentation for children with disabilities ages 6-21. For example, the Department reported 108,537 as the number of children ages 6-21 with limited English proficiency. The Department's supporting documentation revealed a total of only 5,051 children. The Department reported 63,745 as the number of children ages 6-21 without limited English proficiency while the supporting documentation revealed a total of 167,221 children.

Title 34 CFR section 300.752 requires that the State include in its report information that is an accurate and unduplicated count of children with disabilities receiving special education and related services on the date in question. Internal control should be in place to ensure the completeness and accuracy of the report.

This finding impacts the Special Education - Grants to States and Special Education - Preschool Grants for federal funding period July 2006 - September 2007 (H027A060092A and H173A060096).

*Recommendation:* The Department should strengthen control procedures to ensure accurate and complete data in the federal report. Procedures should include a more comprehensive review of the federal report by ensuring that the Department's supporting documentation agrees to reported data prior to the compilation, approval and submission of the federal report.

*Agency Response:* This task has been assigned to the Comprehensive Exceptional Children Accountability System (CECAS) team. This team collects the data that will be input on the report and tests it for accuracy. The data is given to the Policy Chief in the Exceptional Children Division who reviews the data for reasonableness and completes the report. The report is then approved by the Assistant Director and signed by the Director of Exceptional Children. This process should strengthen the control procedures to ensure accurate and complete data are reported.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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### 4. INADEQUATE MAINTENANCE OF EFFORT

The Department did not meet the federal maintenance of effort requirement for the Special Education - Grants to States and Special Education - Preschool Grants programs. Our audit revealed that the Department spent \$1,741 less than was required from nonfederal sources.

Title 34 CFR section 300.154 (effective July 1, 2006) requires that the State not reduce the amount of State financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year. Even though the Department reviewed expenditures on a quarterly basis to ensure compliance with this requirement, our test revealed that the Department provided \$1,741 less in fiscal year 2007 than the State financial support it provided in fiscal year 2006.

This finding impacts the State fiscal year July 2006 - June 2007 (H027A060092A and H173A060096).

*Recommendation:* The Department should strengthen internal control to ensure that the required maintenance of effort compliance requirement is met in accordance with federal regulations. The Department should consider reviewing expenditures more frequently as necessary or on a monthly basis during the last quarter to provide greater assurance that the required level of State expenditures will be met.

*Agency Response:* Procedures have been put in place to insure that the maintenance of effort requirement for the Special Education - Grants to States and Special Education - Preschool Grants programs is met. An administration budget consisting of State funds has been established equal to the amount that must be maintained. In addition, the expenditures are monitored quarterly during the first three quarters of the year and more closely during the final quarter. DPI is confident that the \$1,741 deficiency in the maintenance of effort requirement was actually met by other expenditures throughout the agency although not specifically charged to the cost center being used to calculate the amount spent.

## ORDERING INFORMATION

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://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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