



STATE OF NORTH CAROLINA

OFFICE OF STATE BUDGET AND MANAGEMENT

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES
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State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
Mr. Charlie Perusse, State Budget Director
Office of State Budget and Management

We have completed certain audit procedures at the Office of State Budget and Management related to the State of North Carolina reporting entity as presented in the *Single Audit Report* for the year ended June 30, 2009. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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 major federal 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.

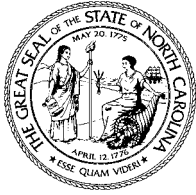
Our audit objective was to render an opinion on the State of North Carolina's administration of major federal programs and not the Office of State Budget and Management's administration of major federal programs. However, the report included herein is in relation to our audit scope at the Office of State Budget and Management and not to the State of North Carolina as a whole.

The audit finding referenced in the report is also evaluated to determine its impact on the State's internal control and the State's compliance with rules, regulations, contracts, and grants. If determined necessary in accordance with *Government Auditing Standards* or the Single Audit Act, this finding is reported in the State's *Single Audit Report*.

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 cursive script that reads "Beth A. Wood".

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State Auditor



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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Mr. Charlie Perusse
and Management of the Office of State Budget and Management

Compliance

As part of our audit of the State of North Carolina's compliance with the types of requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major programs for the year ended June 30, 2009, we have performed audit procedures at the Office of State Budget and Management. Our report on the State of North Carolina's compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 is included in the State's *Single Audit Report*. Our federal compliance audit scope at the Office of State Budget and Management included the following:

- CFDA 84.394: State Fiscal Stabilization Fund (SFSF) – Education State Grants, Recovery Act (Education Stabilization Fund).
- CFDA 84.397: State Fiscal Stabilization Fund (SFSF) – Government Services, Recovery Act

The audit results described below are in relation to our audit scope at the Office of State Budget and Management and not to the State of North Carolina as a whole.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of compliance with those requirements.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

The results of our audit procedures at the Office of State Budget and Management disclosed no instances of noncompliance that are required to be reported in accordance with OMB Circular A-133.

Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency.

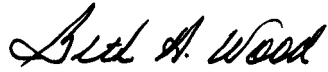
A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the Audit Findings and Responses section of this report to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider the deficiency described in the Audit Findings and Responses section of this report to be a material weakness in relation to our audit scope at the Office of State Budget and Management.

Management's response to the finding identified in our audit is included in the Audit Findings and Responses section of this report. We did not audit the response, and accordingly, we express no opinion on it.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

This report is intended solely for the information and use of management, Mr. Perusse, others within the entity, the Governor, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

March 17, 2010

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AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

ERROR IN LEVEL OF SUPPORT CALCULATION

The Office of State Budget and Management has not implemented adequate internal control to ensure that federal level of effort requirements for the State Fiscal Stabilization Fund have been met. This increases the risk that the program will not be administered in accordance with the federal regulations.

The Office of State Budget and Management's calculation of the State's total expenditures for elementary and secondary education for the 2006 fiscal year was understated by approximately \$104 million. Since the State Fiscal Stabilization Fund regulations require the State to maintain its 2006 level of support in fiscal years 2009, 2010, and 2011, errors in this calculation could cause the State to be out of compliance with the regulations.

The State reported \$5.3 billion as the total elementary and secondary education expenditures for fiscal year 2006 in its revised application for State Fiscal Stabilization Funds. However, this amount did not include the State's allotment for the local educational agencies' central office expenditures totaling \$104 million. Therefore, the 2006 expenditures should have been reported as \$5.4 billion.

In fiscal year 2009, the State expended \$6.4 billion for elementary and secondary education. Since this amount exceeded the required level of support, the State is in compliance with the federal level of effort requirement.

Federal Award Information: This finding impacts federal grant numbers S394A090034 and federal funding period May 20, 2009 – September 30, 2010.

Recommendation: The Office of State Budget and Management should implement effective procedures to ensure that amounts reported in federal applications or federal reports are correct. This could be achieved by adequate independent review and approval of calculations.

Agency Response: OSBM has taken corrective action on the supporting schedules that are used to compute the level of effort reported in the State Fiscal Stabilization Fund – Education grant application. In addition, The United States Department of Education State Fiscal Stabilization Fund contact has been notified of the corrections and the necessary amendment to the grant application has been submitted to reflect these corrections.

It is important to note that even with the adjustments to the level of effort for the FY2006 maintenance of effort (MOE) requirement; North Carolina exceeds its required MOE for elementary and secondary education by \$535 million in FY2010.

As FY2006 is the required MOE year, the level of effort calculations will not change in future years. Therefore, in considering the OSA recommendation to establish an independent

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

review of the supporting schedules used to compute the level of effort, OSBM does not believe this to be a necessary requirement. If federal action necessitates that the MOE be changed, OSBM will perform an independent review of the calculation before submitting the application amendment. As the FY2010 and FY2011 levels of state support in the amended application were projected/enacted levels, OSBM will perform an independent review of the FY2010 and FY2011 state support levels when the amounts are revised for any subsequent required amended application.

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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