



# STATE OF NORTH CAROLINA

**DEPARTMENT OF PUBLIC INSTRUCTION**

**STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2009**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**DEPARTMENT OF PUBLIC INSTRUCTION**

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State Auditor

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**AUDITOR'S TRANSMITTAL**

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The Honorable Beverly Eaves Perdue, Governor  
Members of the North Carolina General Assembly  
The State Board of Education  
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 *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 Department's administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

The audit findings referenced in the report are also evaluated to determine their 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, these findings are 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".

Beth A. Wood, CPA  
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**

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The State Board of Education  
and Management of the Department of Public Instruction

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 Department of Public Instruction. 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 Department of Public Instruction included the following:

- Title I Cluster
  - CFDA 84.010: Title I Grants to Local Educational Agencies (LEAs)
  - CFDA 84.389: Title I Grants to Local Educational Agencies, Recovery Act
- Special Education Cluster
  - CFDA 84.027: Special Education - Grants to States (IDEA, Part B)
  - CFDA 84.173: Special Education - Preschool Grants (IDEA Preschool)
  - CFDA 84.391: Special Education - Grants to States (IDEA, Part B), Recovery Act
  - CFDA 84.392: Special Education - Preschool Grants (IDEA Preschool), Recovery Act
- CFDA 84.048: Career and Technical Education - Basic Grants to States (Perkins IV)

The audit results described below are in relation to our audit scope at the Department 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

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

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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.

The results of our audit procedures at the Department of Public Instruction disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in findings 1 through 5, in the Audit Findings and Responses section of this report.

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 certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

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 deficiencies described in findings 1 through 7 in the Audit Findings and Responses section of this report to be significant deficiencies.

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

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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. Of the significant deficiencies in internal control over compliance described in the Audit Findings and Responses section of this report, we consider findings 1 through 5 to be material weaknesses.

Management'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.

This report is intended solely for the information and use of management, the State Board of Education, the Governor, the General Assembly, others within the entity, 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**

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### **Matters Related to Federal Compliance Objectives**

#### **1. DEFICIENCIES WITH SPECIAL EDUCATION CLUSTER SUBRECIPIENT MONITORING**

We identified deficiencies in the Department's fiscal monitoring procedures for the Special Education cluster grants. These deficiencies increase the risk that noncompliance with federal compliance requirements at the subrecipient level will not be detected. Subrecipients received approximately \$333 million of Special Education funds during the year.

The deficiencies noted are described below:

- The Department's existing monitoring plan requires that each subrecipient be monitored at least once over a five-year period. The monitoring can take the form of site visits or desk reviews. However, only 16 of the 43 subrecipients scheduled for monitoring in fiscal year 2009 were actually monitored.
- The Department did not modify its monitoring plan to ensure that subrecipients of American Recovery and Reinvestment Act (ARRA) funds will be monitored prior to the end of the grant. Without changing its existing monitoring plan, the Department will not monitor some recipients until years after the ARRA funds have been spent. The Department received the grant award notifications for the Special Education ARRA funds in April 2009.
- The Department did not send its monitoring reports, including the required corrective action, to subrecipients in a timely manner. We examined four reports and noted that three were sent to subrecipients six months or more after the monitoring visit. The other report was sent to the subrecipient timely, but did not specify a deadline for when the corrective action had to be taken. The delay in issuing reports and the lack of a deadline for corrective action increase the likelihood that the subrecipients will not take timely corrective action on the findings.

OMB Circular A-133 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.

*Federal Award Information:* This finding impacts these federal programs:

- Special Education - Grants to States: 1) Federal funding periods July 2006 - September 30, 2007 (H027A060092A); 2) July 1, 2007 - September 30, 2008 (H027A070092A); and 3) July 1, 2008 - September 30, 2009 (H027A080092A).



## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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- Special Education - Preschool Grants: 1) Federal funding periods July 1, 2006 - September 30, 2007 (H173A060096); 2) July 1, 2007 - September 30, 2008 (H173A070096); and 3) July 1, 2008 - September 30, 2009 (H173A080096).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092).
- Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096).

*Recommendation:* The Department should implement effective monitoring procedures that ensure timely monitoring of all subrecipients, timely distribution of monitoring reports, and timely corrective action. In addition, special emphasis should be placed on the ARRA funds.

*Agency Response:* The Department is developing fiscal monitoring procedures for the Special Education cluster which will include desk audits of expenditures by all subrecipients each fiscal year as well as onsite visits in conjunction with the program compliance verification visits. The procedures place special emphasis on the ARRA funds. Currently the Department discusses findings with the subrecipients during the onsite visits thus getting a verbal commitment that corrective action will be taken timely. The Department will also issue the formal monitoring reports of these findings within 30 business days of the completion of each onsite visit to further insure the corrective actions are taken.

### 2. CAREER AND TECHNICAL EDUCATION GRANT LACKS FORMALIZED MONITORING PROCEDURES

The Department's monitoring procedures were not adequately documented to demonstrate that it performed sufficient monitoring of the Career and Technical Education funds. This condition limits the Department's ability to ensure that funds granted to subrecipients are expended in accordance with grant requirements. Subrecipients received approximately \$20 million of Career and Technical Education funds during the year.

We tested 27 subrecipients and found that nine were visited by the Career and Technical Education coordinators. However, there was no formal documentation or checklist of what was reviewed during the visits to substantiate that the subrecipients were monitored for compliance with all applicable federal requirements. Although, subrecipients provided a year-end self evaluation of their performance against established performance indicators, the Department did not have any formal ongoing monitoring process to verify the accuracy of the reported information. In addition the Department did not have a formalized plan that identified the subrecipients that would be monitored during the year.

According to 31 US Code 7502, a pass-through entity should monitor the subrecipients' use of federal awards through site visits, limited scope audits, or other means.

## **AUDIT FINDINGS AND RESPONSES (CONTINUED)**

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*Federal Award Information:* This finding impacts federal funding periods July 1, 2007 - September 30, 2008 (V048A070033) and July 1, 2008 - September 30, 2009 (V048A080033).

*Recommendation:* The Department should develop effective monitoring procedures to ensure that subrecipients comply with all applicable federal requirements through scheduled site visits and complete and retain adequate documentation, such as formal reports and checklists.

*Agency Response:* The Department will formalize/appropriately document the Career and Technical Education subrecipient monitoring methodology.

### 3. MANAGEMENT DECISIONS NOT ISSUED TO SUBRECIPIENTS

The Department did not issue management decisions on audit findings after receipt of its subrecipients' audit reports. Management decisions are required to clearly state whether the audit finding is sustained, the reasons for the decision, and the expected auditee action. Without formal management decisions, the subrecipients cannot clearly demonstrate to their auditors or others that the prior audit findings have been resolved and that the corrective action taken was accepted.

Our review of 19 subrecipients' audit reports revealed that seven had findings related to federal awards. The Department communicated with the subrecipients through e-mails or phone calls and ensured that corrective action was taken on the findings. However, the Department did not issue formal management decisions on those audit findings.

OMB Circular A-133 requires a pass-through agency to issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

*Federal Award Information:* This finding impacts these federal programs:

- Title I Grants to Local Education Agencies: Federal funding period July 1, 2007 - September 30, 2008 (S010A070033A).
- Special Education - Grants to States: Federal funding period July 1 2007 - September 30, 2007 (H027A070092A).
- Special Education - Preschool Grants: Federal funding periods July 1, 2007 - September 30, 2008 (H173A070096).
- Career and Technical Education - Basic Grant to States: Federal funding period July 1, 2007 - September 30, 2008 (V048A070033A).

*Recommendation:* The Department should comply with federal regulations by issuing a management decision on audit findings to its subrecipients within six months after receipt of the audit report unless a waiver is granted.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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*Agency Response:* Currently the Department notifies subrecipients when a corrective action does not adequately address an audit finding. The Department does follow-up on audit findings to assure resolutions. The Department will implement a policy to notify subrecipients within six months when items are resolved.

#### 4. FAILURE TO COMMUNICATE ARRA FEDERAL AWARD INFORMATION TO SUBRECIPIENTS

The Department did not make subrecipients aware of all award information and additional compliance requirements associated with the American Recovery and Reinvestment Act (ARRA) funded programs. As a result, there is an increased risk of inaccurate reporting of expenditures and noncompliance with the additional compliance requirements associated with these funds.

The Department did not notify the subrecipients of the federal award numbers and the requirement to provide appropriate identification in their Schedule of Expenditures of Federal Awards and the data collection form. This information is needed to allow the recipient to properly monitor subrecipient expenditures of Recovery Act funds, enable oversight by the federal awarding agencies and other federal officials, and maximize transparency and accountability of these funds. At the end of June 2009, the Department had awarded subrecipients approximately \$18.3 million for the three ARRA funded programs.

Title 2 CFR section 176.210 requires recipients to separately identify the federal award number to each subrecipient at the time of the subaward and disbursement of funds. The recipients must also require their subrecipients to provide appropriate identification in their Schedule of Expenditures of Federal Awards and the data collection form (SF-SAC).

*Federal Award Information:* This finding impacts these ARRA funded programs:

- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092).
- Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096).

*Recommendation:* The Department should implement procedures to identify changes to required award information and compliance requirements and communicate these changes to subrecipients at the time of the award or as soon as the requirement is enacted.

*Agency Response:* Current ARRA grant information was communicated by the Department to subrecipients via weekly emails and the website. Separate program report codes were established for each ARRA grant and that information was relayed to subrecipients. The Department does now have in place a process to communicate all

## **AUDIT FINDINGS AND RESPONSES (CONTINUED)**

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information at the time the grant award document is received, or the requirement is enacted.

### **5. VERIFICATION OF CENTRAL CONTRACTOR REGISTRATION NOT PERFORMED TIMELY**

The Department did not determine whether subrecipients had current Central Contractor Registration before awarding them federal funds for the American Recovery and Reinvestment Act (ARRA) funded programs. As a result, there is an increased risk that awards were made to subrecipients without the proper registration.

The Department made the first ARRA awards to subrecipients in April 2009, but it did not require the subrecipients to certify that they had a current Central Contractor Registration until September 2009. Our review of the Central Contractor Registration database revealed the following:

- Fifteen of the 66 subrecipients who expended Special Education ARRA funds during the fiscal year did not have a current Central Contractor Registration.
- Four of the 19 subrecipients who expended Title I Grants to Local Education Agencies ARRA funds during the fiscal year did not have a current Central Contractor Registration.

Title 2 CFR section 176.50 requires recipients and their first-tier recipients to maintain current registrations in the Central Contractor Registration at all times during which they have active federal awards funded with ARRA funds.

*Federal Award Information:* This finding impacts these ARRA funded programs:

- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092).
- Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096).

*Recommendation:* The Department should implement effective procedures to verify that subrecipients have current Central Contractor Registration before awarding subrecipients ARRA funds. The Department should also implement controls to check whether subrecipients are updating information when necessary.

*Agency Response:* Each month, prior to the submission of the quarterly report, the Department will notify subrecipients that they must review their CCR registration, and the Department will verify the information by entering each DUNS number in the Central Contractor Registry.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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### 6. ACTION NOT TAKEN ON MAINTENANCE OF EFFORT REQUIREMENT

The Department did not take appropriate action on a subrecipient that did not meet the required maintenance of effort for the Title I Cluster. The Department did not reduce the subrecipients' Title I allocation during the fiscal year as required by federal regulations.

The Department calculated the maintenance of effort in January 2009 to determine which subrecipients failed to maintain the required fiscal effort. One subrecipient failed to maintain the required fiscal effort by approximately \$90,000 or 13 percent of its Title I Cluster allocation. However, the Department did not reduce the subrecipient's allocation of Title I Cluster funds by 13 percent as required by federal regulations until our audit inquiry in November 2009.

According to 20 US Code section 7901, the State must reduce the amount of the allocation of funds in any fiscal year in the exact proportion by which the subrecipient fails to meet the maintenance of effort.

*Federal Award Information:* This finding impacts these federal programs:

- Title I Grants to Local Education Agencies: Federal funding period July 1, 2008 - September 30, 2009 (S010A080033A).
- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).

*Recommendation:* The Department should implement an effective control to ensure that Title I funds are reduced for subrecipients that fail to meet the level of effort requirement.

*Agency Response:* The failure to reduce the Title I funding of the subrecipient, that did not meet the required maintenance of effort, was an oversight and the funding will be reduced. We have implemented an additional step in the process to minimize the possibility of this oversight occurring again.

### 7. PERSONNEL COSTS CHARGED TO CAREER AND TECHNICAL EDUCATION GRANT IN ERROR

The Department erroneously charged part of two employees' salaries and benefits to the Career and Technical Education grant. As a result, funds were spent for unallowed costs. Controls were not in place to ensure that only allowable personnel costs were charged to the program.

Our tests of administrative expenditures revealed that a portion of two employees' salaries and benefits were charged to the Career and Technical Education grant for the entire year even though these employees were not working with this grant. The Department identified this error and made an adjustment to charge the salaries to the appropriate grants. However, the Department's adjustment only removed a portion of the cost, leaving \$5,265 of unallowable costs.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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According to OMB Circular A-87, costs are allocable to a grant only if benefits are received by that grant.

*Federal Award Information:* This finding impacts federal funding periods July 1, 2006 - September 30, 2007 (V048A060033) and July 1, 2007 - September 30, 2008 (V048A070033).

*Recommendation:* The Department's budget personnel should provide to the director of the Career and Technical Education grants an annual updated list of all personnel to be paid from Career and Technical Education funds. This list should be reviewed to ensure that only assigned personnel's salaries will be charged to the Career and Technical Education grant. The Department should also strengthen controls over adjustments to ensure that it reflects the entire year's activity.

*Agency Response:* The Department's budget personnel do provide a current list of all personnel being paid from the Career and Technical Education grant to the director and require the director to sign off on the document indicating agreement with the staff being charged. In this instance, staff was made aware that the responsibilities of two staff on the list had changed and the funding supporting their positions was permanently changed. However, the permanent change occurred late in the fiscal year and the staff responsible for transferring the payroll expenditures coded to the Career and Technical Education grant failed to do so. The Department will reimburse the Career and Technical Education grant for this questioned cost.

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