



STATE OF NORTH CAROLINA

DEPARTMENT OF PUBLIC INSTRUCTION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF PUBLIC INSTRUCTION
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AUDITOR'S TRANSMITTAL

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, 2010. 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; 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*.

Our audit objective was to render an opinion on the State of North Carolina's, 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 OMB Circular A-133, 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 THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

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 could have a direct and material effect on each of its major programs for the year ended June 30, 2010, we have performed audit procedures at the Department of Public Instruction. Our report on the State of North Carolina's compliance with requirements that could have a direct and material effect on 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:

- Child Nutrition Cluster

CFDA 10.553: School Breakfast Program

CFDA 10.555: National School Lunch Program

CFDA 10.556: Special Milk Program for Children

- Title I Cluster

CFDA 84.010: Title I Grants to Local Educational Agencies

CFDA 84.389: Title I Grants to Local Educational Agencies, Recovery Act

- Special Education Cluster

CFDA 84.027: Special Education – Grants to States

CFDA 84.173: Special Education – Preschool Grants

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

CFDA 84.391: Special Education – Grants to States, Recovery Act

CFDA 84.392: Special Education – Preschool Grants, Recovery Act

- State Fiscal Stabilization Fund Cluster

CFDA 84.394: State Fiscal Stabilization Fund – Education State Grants, Recovery Act

CFDA 84.397: State Fiscal Stabilization Fund – Government Services, Recovery Act

- CFDA 84.048: Career and Technical Education - Basic Grants to States

- CFDA 84.367: Improving Teacher Quality State Grants

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 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 the Department's 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 6 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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, we consider the deficiencies described in findings 1 through 6 in the Audit Findings and Responses section of this report to be material weaknesses in internal control over compliance, as defined above. Furthermore, we consider the deficiencies described in findings 7 and 8 in the Audit Findings and Responses section of this report to be significant deficiencies in internal control over compliance, as defined above.

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, others within the entity, the Governor, the General Assembly, 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 11, 2011

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. DEFICIENCIES IN SUBRECIPIENT MONITORING PROCESS

We identified deficiencies in the Department's fiscal monitoring procedures for the Special Education cluster and the State Fiscal Stabilization Fund grants. These deficiencies increase the risk that noncompliance with federal compliance requirements at the subrecipient level will occur and not be detected in a timely manner. During the year, subrecipients received approximately \$407 million and \$346 million of Special Education and State Fiscal Stabilization funds, respectively.

The deficiencies noted are described below:

- The Department's existing monitoring plan requires each subrecipient to be monitored at least once over a five-year period. The monitoring can take the form of site visits or desk reviews. However, only 29 of the 46 subrecipients scheduled for monitoring in fiscal year 2010 were actually monitored.
- The Department did not modify its existing monitoring plan to ensure subrecipients of American Recovery and Reinvestment Act (ARRA) funds will be monitored prior to the end of the grant period. Without changing its existing monitoring plan, the Department will not monitor some recipients until years after the ARRA funds have been spent.
- The Department did not send fiscal monitoring reports to any charter school subrecipients. In addition, the Department did not obtain the required fiscal corrective action plans from charter schools. This failure to issue reports or obtain required corrective action plans increases the likelihood that the subrecipients will not address the findings or take timely corrective action.
- The Department did not monitor subrecipients for compliance with state policies and procedures when federal funds were used for the procurement of goods and services. Also, the Department did not monitor subrecipients to ensure subrecipients did not contract or provide federal funds to suspended or debarred individuals or organizations.

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.

Significant aspects of this finding for the Special Education Cluster grants were also reported in a prior year finding.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Federal Award Information: This finding impacts these federal programs:

- a. Special Education - Grants to States: 1) Federal funding periods July 1, 2007 - September 30, 2008 (H027A070092A); 2) July 1, 2008 - September 30, 2009 (H027A080092A); and 3) July 1, 2009 - September 30, 2010 (H027A090092A).
- b. Special Education - Preschool Grants: Federal funding periods: 1) July 1, 2007 - September 30, 2007 (H173A070096); 2) July 1, 2008 - September 30, 2009 (H173A080096); and 3) July 1, 2009 - September 30, 2010 (H173A090096).
- c. Special Education - Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- d. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).
- e. State Fiscal Stabilization Fund - Education State Grant, Recovery Act: Federal funding period May 20, 2009 - September 30, 2010 (S394A090034).

Recommendation: The Department should implement effective monitoring procedures that ensure timely and adequate monitoring of all subrecipients for all applicable compliance requirements. The monitoring reports should be distributed and corrective action plans tracked to ensure that the issues are being addressed. In addition, special emphasis should be placed on the ARRA funds.

Agency Response: The Department believes the fiscal monitoring procedures, which were recently revised as a result of the audit finding, now address all compliance requirements effectively and adequately. The Department has made position reassignments which will allow desk monitoring of all State Fiscal Stabilization Fund subrecipients prior to the end of the grant period as well as timely issuance of written monitoring reports and follow-up on corrective actions. The Department is placing special emphasis on ARRA funds.

2. TITLE I SUBRECIPIENT MONITORING PROCESS NEEDS IMPROVEMENT

We identified deficiencies in the Department's monitoring procedures for the Title I Cluster grants. These deficiencies increase the risk that noncompliance with federal compliance requirements at the subrecipient level will occur and not be detected. Subrecipients received approximately \$462 million in Title I cluster funds during the year.

The deficiencies noted are described below:

- The Department did not modify its existing monitoring plan to ensure that subrecipients of the American Recovery and Reinvestment Act (ARRA) funds will be monitored prior to the end of the grant period. Without changing its existing

AUDIT FINDINGS AND RESPONSES (CONTINUED)

monitoring plan, the Department will not monitor some recipients until years after the ARRA funds have been spent.

- The Department did not monitor subrecipients for compliance with state policies and procedures when federal funds are used for the procurement of goods and services. Also, the Department did not monitor subrecipients to ensure subrecipients did not contract or provide federal funds to suspended or debarred individuals or organizations.
- The Department included the comparability requirement on its monitoring checklist. However, it did not review documentation supporting the calculations used in the comparability reports to ensure the reports were correct. The comparability requirement demands that schools funded under Title I provide services comparable to those in schools that do not receive Title I funding.
- The Department noted deficiencies in its monitoring of two of the nine subrecipients we tested; however, only one had submitted a corrective action plan. A written corrective action plan is required to ensure deficiencies are timely and properly addressed. The Department did not have a tracking system to ensure corrective action plans were received or implemented.

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:

- Title I Grants to Local Education Agencies: Federal funding periods: 1) July 1, 2007 - September 30, 2008 (S010A070033A); 2) July 1, 2008 - September 30, 2009 (S010A080033A); and 3) July 1, 2009 - September 30, 2010 (S010A090033A).
- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033A).

Recommendation: The Department should implement effective monitoring procedures that ensure timely and adequate monitoring of all subrecipients for all applicable compliance requirements. It should also ensure corrective action plans are received and implemented. In addition, special emphasis should be placed on the ARRA funds.

Agency Response: The Department will implement effective monitoring procedures which include onsite reviews, desk reviews and self-monitoring reports. Program staff will be trained on how to review for comparability and procedures are now in place to ensure corrective action plans are received and implemented. The Department believes the fiscal monitoring procedures, which were recently revised as a result of the audit

AUDIT FINDINGS AND RESPONSES (CONTINUED)

finding, now address all compliance requirements effectively and adequately. The Department is placing special emphasis on ARRA funds.

3. WEAKNESSES IN IMPROVING TEACHER QUALITY SUBRECIPIENT MONITORING PROCESS

We identified deficiencies in the Department's monitoring procedures for the Improving Teacher Quality State Grant. These deficiencies increase the risk that noncompliance with federal compliance requirements at the subrecipient level will occur and not be detected in a timely manner. Subrecipients received approximately \$58 million of Improving Teacher Quality funds during the year.

The weaknesses identified are described below:

- The Department did not monitor subrecipients to ensure all teachers hired to teach in Title I programs were highly qualified at the time of hire as required by federal regulations.
- The Department did not maintain sufficient documentation to support results of its performance monitoring visits. Five of the 10 monitoring visits tested did not have any documentation to support the monitoring results.
- Reviews of the performance monitoring reports were conducted by each individual monitoring team. However, there was not an independent supervisory review to ensure that the reports clearly reflected the monitoring results.
- The Department did not send its fiscal monitoring reports to its charter school subrecipients. In addition, the Department did not obtain the required fiscal corrective action plans from charter schools. This failure to issue reports or obtain required corrective action plans increases the likelihood that the subrecipients will not address the findings or take timely corrective action.
- The Department did not monitor subrecipients for compliance with the requirement to supplement rather than supplant program expenditures. This requirement prevents a subrecipient from using federal funds to provide program services paid for with non-federal funds in the prior year.
- The Department did not monitor subrecipients for compliance with state policies and procedures when federal funds are used for the procurement of goods and services. Also, the Department did not monitor subrecipients to ensure subrecipients did not contract or provide federal funds to suspended or debarred individuals or organizations.

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.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Federal Award Information: This finding impacts federal funding periods: 1) July 1, 2007 - September 30, 2008 (S367A070032A); 2) July 1, 2008 - September 30, 2009 (S367A080032A); and 3) July 1, 2009 - September 30, 2010 (S367A090032A).

Recommendation: The Department should implement effective monitoring procedures to ensure adequate monitoring of all subrecipients for all applicable compliance requirements. The Department should also ensure that the monitoring reports are independently and effectively reviewed and then distributed timely.

Agency Response: The Department is implementing revisions and additions to the monitoring protocol and procedures to address all program compliance findings. Position reassignments will allow timely issuance of written monitoring reports and follow-up on corrective actions. The Department believes the fiscal monitoring procedures, which were recently revised as a result of the audit finding, now address all compliance requirements effectively and adequately.

4. INADEQUATE SUBRECIPIENT MONITORING OF THE CAREER AND TECHNICAL EDUCATION GRANT

We identified deficiencies in the Department's monitoring of fiscal activities for the Career and Technical Education grant. As a result, there is an increased risk that noncompliance at the subrecipient level could occur and not be detected in a timely manner. Subrecipients received approximately \$20 million of Career and Technical Education funds during the year.

The deficiencies noted are described below:

- We tested 27 subrecipients and found that the Department did not have any documentation to show that it monitored 22 subrecipients for fiscal activities.
- The Department did not monitor subrecipients for compliance with the requirement to supplement and not supplant program expenditures. This requirement prevents a subrecipient from using federal funds to provide program services paid for with non-federal funds in the prior year.

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.

Significant aspects of this finding were also reported in the prior year.

Federal Award Information: This finding impacts federal funding periods July 1, 2007 - September 30, 2008 (V048A070033A), July 1, 2008 - September 30, 2009 (V048A080033A) and July 1, 2009 - September 30, 2010 (V048A090033A).

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should implement effective monitoring procedures to ensure subrecipients comply with all applicable federal fiscal requirements. Also, the Department should complete and retain adequate documentation of monitoring activities.

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

5. 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.

We reviewed the Department's monitoring tracking sheet and noted that 21 subrecipients had findings related to federal awards. The Department communicated with the subrecipients through e-mails and/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.

This finding was also reported in the prior year.

Federal Award Information: This finding impacts these federal programs:

- a. School Breakfast Program, National School Lunch Program, and Special Milk Program for Children: Federal funding Period October 1, 2008 - September 30, 2009 (5NC300327).
- b. Title I Grants to Local Education Agencies: Federal funding period July 1, 2008 - September 30, 2009 (S010A080033A).
- c. Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).
- d. Special Education - Grants to States: Federal funding period July 1, 2008 - September 30, 2009 (H027A080092A).
- e. Special Education - Preschool Grants: Federal funding periods July 1, 2008 - September 30, 2009 (H173A080096).

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- f. Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- g. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).
- h. Career and Technical Education - Basic Grant to States: Federal funding period July 1, 2008 – September 30, 2009 (V048A080033A).
- i. Improving Teacher Quality State Grants: Federal funding period July 1, 2008 - September 30, 2009 (S367A080032A).

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.

Agency Response: The Department will issue a management decision on audit findings to all subrecipients within six months after receipt of the audit.

6. FAILURE TO COMMUNICATE ARRA FEDERAL AWARD INFORMATION TO SUBRECIPIENTS

The Department did not communicate to subrecipients the 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 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 for these funds. The Department awarded subrecipients approximately \$598.7 million from the four ARRA funded grants.

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.

This finding was also reported in the prior year. The Department responded to the prior year finding by stating that ARRA grant information was communicated to subrecipients via weekly e-mails and the website. Our follow-up revealed that the Department had the ARRA grant information on its website. However, the Department did not provide any evidence that it communicated to subrecipients the availability of this information on its

AUDIT FINDINGS AND RESPONSES (CONTINUED)

website. As a result, subrecipients might not have been aware about the required information on the Department's website.

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 (S389A090033A).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).
- State Fiscal Stabilization Fund - Education State Grant, Recovery Act: Federal funding period May 20, 2009 - September 30, 2010 (S394A090034).

Recommendation: The Department should implement effective procedures to communicate federal award information to its subrecipients.

Agency Response: The Department will implement procedures notifying subrecipients when ARRA federal award information is added to the Department's website.

7. FAILURE TO MONITOR SUBRECIPIENTS FOR STATE REVENUE MATCH

The Department did not monitor subrecipients of the National School Lunch Program (NSLP) to ensure subrecipients used state revenue matching funds for authorized purposes. As a result, there is an increased risk that the state revenue matching funds will be used for unallowable program activities.

The Department provided subrecipients approximately \$7.6 million in state funds to comply with the federal matching requirement of the NSLP. The Department monitored subrecipients for the use of federal funds. However, it did not monitor subrecipients to determine whether state matching funds were used for allowable program expenses.

Title 7 CFR section 3016.40 requires grantees to monitor grant and subgrant supported activities to ensure compliance with applicable federal requirements and that performance goals are being achieved. Expenditures have to be for allowable activities in order to qualify as matching funds.

Federal Award Information: This finding impacts federal funding period October 1, 2008 - September 30, 2009 (5NC300327).

Recommendation: The Department should establish and implement monitoring procedures to ensure subrecipients use state matching funds for allowable program activities.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: The Department believes internal controls and fiscal monitoring procedures, which were recently revised as a result of this audit finding, ensure subrecipients use state matching funds for allowable program activities.

8. CONTROL WEAKNESS OVER MAINTENANCE OF EFFORT REQUIREMENT

Although the Department met the maintenance of effort requirement for the Special Education Cluster grants, the Department did not have adequate internal control to ensure continual compliance with this requirement. As a result, there is an increased risk that the Department will not meet this requirement in the future.

Title 34 CFR section 300.163 states that a State must 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.

At the time of our audit in November 2010, the Department had not yet obtained the amounts spent by other state agencies to determine if the maintenance of effort requirement had been met. After our inquiry, the Department obtained and computed actual expenditure amounts to determine whether the requirement had been met.

This computation included these categories of state expenditures for children with disabilities in fiscal year 2010:

- State funds of approximately \$686 million provided to subrecipients.
- The Department's own expenditures of approximately \$297,000 for administering the children with disabilities program.
- State expenditures of approximately \$49 million from other state agencies.

The Department tracked its own state expenditures and also state funds provided to subrecipients. However, the Department did not track state expenditures made by other state agencies for children with disabilities. Should the State ever fall short in its combined efforts to meet the required maintenance of effort, the Department will not identify the shortage until it is too late to take corrective action.

OMB Circular A-133 states that an auditee must maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Federal Award Information: This finding impacts these federal programs:

- a. Special Education - Grants to States: Federal funding period July 1, 2009 - September 30, 2010 (H027A090092A).
- b. Special Education - Preschool Grants: Federal funding periods July 1, 2009 - September 30, 2010 (H173A090096).
- c. Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- d. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).

Recommendation: The Department should strengthen internal control to ensure that the maintenance of effort compliance requirement is continually met in accordance with federal regulations.

Agency Response: The State of North Carolina has been fortunate during the economic downturn to continue to provide adequate funding for Children with Disabilities which allows the Department to maintain the level of effort. To further strengthen internal controls the Department will develop a plan for the monitoring of state-wide maintenance of effort on a quarterly basis for Special Education Grants to states and request a waiver of this compliance requirement from the U.S. Department of Education if the State is not going to meet the maintenance of effort.

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