



STATE OF NORTH CAROLINA

DEPARTMENT OF PUBLIC INSTRUCTION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF PUBLIC INSTRUCTION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

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, 2011. 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



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

**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, 2011, 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

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

CFDA 84.392: Special Education - Preschool Grants, Recovery Act

**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 84.394: State Fiscal Stabilization Fund - Education State Grants, Recovery Act
- CFDA 84.048: Career and Technical Education - Basic Grants to States
- CFDA 84.367: Improving Teacher Quality State Grants
- CFDA 84.287: Twenty-First Century Community Learning Centers
- CFDA 84.410: Education Jobs Fund

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 3 and 4 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 the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

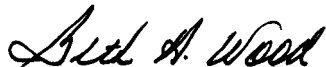
**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A
DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

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 4 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 5 through 10 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, 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 9, 2012

[This Page Left Blank Intentionally]

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. INSUFFICIENT DOCUMENTATION IN TITLE I SUBRECIPIENT MONITORING PROCESS

The Department did not maintain documentation demonstrating it performed certain monitoring procedures on subrecipients of the Title I Cluster grants. This condition limits the Department's ability to ensure funds granted to subrecipients are expended in accordance with grant requirements. Subrecipients received approximately \$474 million of Title I Cluster funds during the year.

In an effort to ensure that all subrecipients with American Recovery and Reinvestment Act (ARRA) funds would be monitored prior to the end of the grant period, the Department decided to monitor all subrecipients by comparing their actual expenditures with their approved budgets. We tested 41 subrecipients and noted that the Department did not have documentation to support that it performed a "budget versus expenditure" analysis for 31 subrecipients. According to the Department, supporting documentation was not retained if the subrecipients' excess expenditures were within 10 percent of their approved budgets.

OMB Circular A-133 requires an auditee to maintain internal control over federal programs providing 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.

Federal Award Information: This finding impacts these federal programs:

- a. Title I Grants to Local Education Agencies: Federal funding period July 1, 2010 - September 30, 2011 (S010A100033A).
- b. Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).

Recommendation: The Department should implement effective controls to ensure supporting documentation of its monitoring activities is maintained for a reasonable period.

Agency Response: The Department will implement effective controls that ensure adequate supporting documentation is maintained for all monitoring activities. Special emphasis will be placed on any remaining ARRA funds. In addition, the Department's School Business Division's Compliance and Monitoring Section will provide documentation of monitoring procedures and training to Department federal program staff. This training and documentation will include sufficient support of the monitoring and review procedures for both desk and on site visits as it pertains to financial data.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

2. WEAKNESSES IN IMPROVING TEACHER QUALITY SUBRECIPIENT MONITORING PROCESS

The Department's monitoring procedures for subrecipients of the Improving Teacher Quality State Grants contained deficiencies. These deficiencies increase the risk that noncompliance with federal requirements at the subrecipient level could occur and not be detected in a timely manner. Subrecipients received approximately \$62 million of Improving Teacher Quality funds during the year. The weaknesses identified are described below:

- The Department did not maintain sufficient documentation to support the results of its performance monitoring visits. One of the eight monitoring visits tested did not have any documentation to support the monitoring results. Another visit had only a partially completed monitoring questionnaire.
- Reviews of the performance monitoring reports were conducted by the same individuals who performed the monitoring. There was not an independent supervisory review to ensure the reports clearly reflected the monitoring results.
- 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.

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.

These issues were also reported in the prior year.

Federal Award Information: This finding impacts federal funding period July 1, 2010 - September 30, 2011 (S367A100032A).

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.

Agency Response: The Department is implementing revisions to monitoring procedures and monitoring instruments to address all program compliance findings. As a result of this audit, appropriate documentation is being retained, independent reviews are being performed, and the monitoring instrument has been revised to include "supplement not supplant" procedures. The Department believes these recent revisions to monitoring procedures will address all compliance requirements adequately and effectively. In addition, the Department's School Business Division's Compliance and Monitoring Section will provide documentation of monitoring procedures and training to Department federal program staff. This training and documentation will include sufficient support of

AUDIT FINDINGS AND RESPONSES (CONTINUED)

the monitoring and review procedures for both desk and on site visits as it pertains to financial data.

3. TWENTY-FIRST CENTURY GRANT LACKED FORMALIZED MONITORING PROCEDURES

The Department's monitoring procedures were not adequately documented to demonstrate that it performed sufficient monitoring of the Twenty-First Century Community Learning Centers funds. This condition limited the Department's ability to ensure funds granted to subrecipients were expended in accordance with grant requirements. During the year, subrecipients received approximately \$41 million of Twenty-First Century Community Learning Centers funds.

We noted deficiencies in the Department's on-site monitoring as described below:

- There was no evidence of review or approval of the monitoring reports to ensure the reports clearly reflected the monitoring results.
- We tested 23 subrecipients that received on-site monitoring and noted inadequate documentation for 12 subrecipients as follows:
 - a. Eight monitoring reports had an overall rating of 'met' for each compliance indicator. However, there was no documentation to support that assessment. The Department's monitoring procedures do not require the consultants to complete the supporting documentation unless an exception is identified.
 - b. The overall rating summary was not completed for one monitoring report although the supporting documentation was completed.
 - c. Three monitoring reports had ratings of "not met" that required the subrecipients to submit a corrective action plan to the Department within 10 days of the report. However, the plans were not submitted, and there was no evidence that the Department performed follow-up procedures accordingly.
- The special test requirement relating to the participation of private school children was not included in the monitoring instrument. As a result, there was no indication that the Department monitored this compliance requirement passed down to subrecipients.

The Department also utilized desk reviews to monitor subrecipients. The desk reviews consisted of various monitoring activities, including review of profile sheets, self-evaluation reports, and cash reimbursement requests. The monitoring process allowed program consultants to determine which forms of desk reviews could be used to monitor subrecipients. As a result, the various forms of desk reviews were not uniformly applied to all subrecipients. In addition, there was no evidence of review or approval of the completed monitoring tools to ensure the tools were used as designed.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

We reviewed the files for the desk reviews of 53 subrecipients and noted the following:

- Forty subrecipients had profile sheets that documented student attendance, current program sites, and changes in contact information. However, there was no evidence to support the Department's review of the profile sheets.
- Six subrecipients had cash reimbursement requests. However, the Department did not provide adequate evidence to support its review of one subrecipient's cash reimbursement request.
- Fourteen subrecipients submitted self-evaluation reports that showed their progress assessment in achieving the goal of providing high quality opportunities for academic enrichment. However, there was no evidence to support the Department's review of the self-evaluation reports.

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 federal funding period July 1, 2010 - September 30, 2011 (S287C100033).

Recommendation: The Department should develop and implement effective monitoring procedures to ensure it adequately monitors subrecipients for all applicable compliance requirements. In addition, the Department should complete and retain adequate supporting documentation for the monitoring procedures performed.

Agency Response: The Department will develop procedures and revise monitoring instruments to ensure adequate and effective monitoring of subrecipients for all related compliance findings. Department staff will collect and retain documentation of all monitoring activity documentation and ensure documentation is kept in a master file. In addition, the Department's School Business Division's Compliance and Monitoring Section will provide documentation of monitoring procedures and training to Department federal program staff. This training and documentation will include sufficient support of the monitoring and review procedures for both desk and on site visits as it pertains to financial data.

4. ALLOTMENTS NOT RECONCILED TO SFSF GRANT AWARDS

The Department did not have effective procedures in place to ensure the unexpended State Fiscal Stabilization Funds (SFSF) award balance in its accounting records was reconciled to the allotment balance in the external accounting system. The external accounting system is the system used to record the approved allotment amounts of eligible subrecipients and related subrecipient expenditures. As a result, the Department had approximately \$24 million in SFSF funds on hand at year end.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

During the audit year, the Office of State Budget and Management (OSBM), which is the state agency responsible for drawing down the federal awards for this grant, increased the amount of the SFSF provided to the Department by approximately \$25 million. OSBM instructed the Department to use these additional SFSF funds to replace state funds. The Department's School Business Staff then allotted the additional \$25 million to subrecipients.

The Department drew down approximately \$24 million in SFSF funds in December 2010. Unaware of the allotments made by School Business Staff, the Department's Financial Services Staff used these additional funds to replace state expenditures as they interpreted OSBM's instructions. The state expenditures were moved to SFSF through a journal entry. These actions resulted in double commitment of the same funds.

The Department detected the double commitment of funds at year end. Since a portion of the funds allotted had already been disbursed to subrecipients, the Department rectified the double commitment of funds by reclassifying the expenditures coded as SFSF expenditures back to state expenditures. As a result, the Department had unearned SFSF funds of approximately \$24 million at year end that were not completely used until September 2011.

The Treasury-State Agreement requires the State to request funds such that they are deposited in a state account not more than three days prior to the actual disbursement of those funds.

Federal Award Information: This finding impacts federal funding period May 20, 2009 - September 30, 2010 (S394A090034).

Recommendation: The Department should ensure directives and actions that necessitate revisions to award amounts be communicated to the appropriate staff. In addition, the Department should establish procedures to ensure allotment amounts and accounting records are properly and periodically reconciled.

Agency Response: The Department will ensure fiscal directives are effectively communicated and discussed among the appropriate staff before taking action. The Department's existing monthly internal to external grant reconciliation will be expanded to include a reconciliation of the internal available grant balances to the external available to draw by grant.

5. MANAGEMENT DECISIONS NOT ISSUED TO SUBRECIPIENTS FOR SIGNIFICANT DEFICIENCY FINDINGS

The Department did not issue management decisions to its subrecipients for significant deficiency findings as required by OMB Circular A-133. 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

AUDIT FINDINGS AND RESPONSES (CONTINUED)

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.

In prior years, the Department did not issue formal management decisions on any type subrecipient audit finding. In an effort to correct the issue, the Department began issuing management decisions on material findings. However, the requirement for management decisions applies to significant findings as well.

We examined 58 audit reports for subrecipients that expended \$500,000 or more in federal awards and noted that 18 subrecipients had significant deficiency findings related to federal awards. 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:

- a. School Breakfast Program, National School Lunch Program, and Special Milk Program for Children: Federal funding Period October 1, 2009 - September 30, 2010 (5NC300327).
- b. Title I Grants to Local Education Agencies: Federal funding period July 1, 2009 - September 30, 2010 (S010A090033A).
- 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, 2009 - September 30, 2010 (H027A090092A).
- e. Special Education - Preschool Grants: Federal funding periods July 1, 2009 - September 30, 2010 (H173A090096).
- 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, 2009 - September 30, 2010 (V048A090033A).
- i. Improving Teacher Quality State Grants: Federal funding period July 1, 2009 - September 30, 2010 (S367A090032A).
- j. State Fiscal Stabilization Fund - Education State Grant, Recovery Act: Federal funding period May 20, 2009 - September 30, 2010 (S394A090034).

AUDIT FINDINGS AND RESPONSES (CONTINUED)

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

Agency Response: Previously, the Department only issued formal management decisions to subrecipients on material findings. The Department now issues formal management decisions on all audit findings to all subrecipients within six months after receipt of the audit report.

6. MONITORING OF CASH MANAGEMENT PROCEDURES NEEDS IMPROVEMENT

The Department did not have adequate monitoring procedures to ensure subrecipients disbursed federal funds in a timely manner as required by federal and state cash management requirements. As a result, there is an increased risk that a subrecipient could accumulate federal funds in its account and fail to disburse them in a timely manner. During the year, subrecipients received approximately \$1.5 billion in federal funds for all grants.

The Treasury-State Agreement requires that the State request funds such that they are deposited in a state account not more than three days prior to the actual disbursement of those funds. Also, 34 CFR section 80.20 requires the State to monitor cash drawdowns by its subrecipients to assure that they conform substantially to the same standards as the State.

The Department's cash management monitoring procedures did not ensure subrecipients expended federal funds within three days of receipt. At the end of each month, the Department determined whether subrecipients had requested funds in excess of actual expenditures for the month. This procedure was inadequate as it did not determine whether funds were spent within three days of receipt. During its fiscal monitoring visits, the Department determined if the subrecipients had policies and procedures over their cash management process but did not verify that the procedures were actually being followed.

Federal Award Information: This finding impacts these federal programs:

- a. Title I Grants to Local Education Agencies: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (S010A080033A); 2) July 1, 2009 - September 30, 2010 (S010A090033A); and 3) July 1, 2010 - September 30, 2011 (S010A100033A).
- b. Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).
- c. Special Education - Grants to States: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (H027A080092A); 2) July 1, 2009 - September 30, 2010 (H027A090092A); and 3) July 1, 2010 - September 30, 2011 (H027A100092A).

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- d. Special Education - Preschool Grants: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (H173A080096); 2) July 1, 2009 - September 30, 2010 (H173A090096); and 3) July 1, 2010 - September 30, 2011 (H173A100096).
- e. Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- f. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).
- g. Career and Technical Education - Basic Grant to States: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (V048A080033A); 2) July 1, 2009 - September 30, 2010 (V048A090033A); and 3) July 1, 2010 - September 30, 2011 (V048A100033A).
- h. Improving Teacher Quality State Grants: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (S367A080032A); 2) July 1, 2009 - September 30, 2010 (S367A090032A); and 3) July 1, 2010 - September 30, 2011 (S367A100032A).
- i. Twenty-First Century Community Learning Centers: Federal funding periods: 1) July 1, 2008 - September 30, 2009 (S287C080033); 2) July 1, 2009 - September 30, 2010 (S287C090033); and 3) July 1, 2010 - September 30, 2011 (S287C100033).
- j. State Fiscal Stabilization Fund - Education State Grant, Recovery Act: Federal funding period May 20, 2009 - September 30, 2010 (S394A090034).
- k. Education Jobs Fund: Federal funding period: August 10, 2010 - September 30, 2011 (S410A100034).

Recommendation: The Department should implement effective monitoring procedures to ensure subrecipients draw down and disburse federal funds in accordance with federal and state cash management requirements.

Agency Response: The Department is implementing a process that will monitor requested funds with actual disbursements in addition to zeroing out grant funds at the end of each month. In addition, the Department will include a test of the LEA's revenue and cash disbursement cycle in all pertinent monitoring procedures and instruments as well as the current monitoring by annually required CPA audits.

7. INCOMPLETE SUBMISSION OF QUARTERLY RECOVERY ACT REPORTS

The Department did not include the final month's expenditures in each of the submitted quarterly reports on the use of the American Recovery and Reinvestment Act funds. As a result, submission of the incomplete reports resulted in noncompliance with federal report preparation guidelines and could reduce the usefulness of data to the users.

Section 1512 of the American Recovery and Reinvestment Act requires quarterly reporting on the use of funds. OMB Circular A-133 guidance regarding 1512 reporting requires recipients to report expenditures as of the last day of the quarter. In the absence

AUDIT FINDINGS AND RESPONSES (CONTINUED)

of complete actual expenditures for the quarter, recipients are required to use the “best available data,” which should represent the full quarter and can include estimates. The guidance states the use of a “lag” methodology that utilizes finalized data for two months of a quarter and excludes the final month of the quarter is inappropriate. OMB has indicated that the reporting of anything less than a full quarter or the use of the “lag” methodology would be considered noncompliance with 1512 reporting requirements and would result in a reportable audit finding.

The Department utilized the “lag” methodology in all four submitted quarterly reports. For example, the March 31 quarterly report submitted by the Department contained expenditures incurred up to February 2011, thus excluding the March 2011 expenditures that totaled approximately \$72 million.

Federal Award Information: This finding impacts these federal programs:

- a. Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).
- b. Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).
- c. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096A).
- d. State Fiscal Stabilization Fund - Education State Grant, Recovery Act: Federal funding period May 20, 2009 - September 30, 2010 (S394A090034).
- e. Education Jobs Fund: Federal Funding Period: August 10, 2010 - September 30, 2011 (S410A100034).

Recommendation: The Department should comply with federal guidelines by ensuring that the quarterly reports include the “best available data” for the entire reporting period. If the “best available data” contains estimates, the Department should have a process in place to review the submitted reports once the actual expenditures are available and determine if there are any material differences that would require the report to be revised during the federal continuous correction period.

Agency Response: Effective with 1512 reporting for quarter ending June 30, 2011, the Department includes the “best available data” for the entire reporting period and makes any needed revisions within the continuous correction period.

8. INADEQUATE MONITORING OF SUBRECIPIENTS FOR THE STATE REVENUE MATCH

The Department did not adequately 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 could be used for unallowable program activities.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Department provided NSLP subrecipients approximately \$7 million in state funds to comply with the federal matching requirement. The Department compared summary level expenditures reported by the subrecipients to allowable account codes for the state revenue match. However, it did not review supporting documentation of the reported expenditures to determine whether individual transactions were coded correctly.

During the audit period, the Department developed procedures to review supporting documentation of the state revenue match during on-site visits. However, these procedures were not implemented during the audit period.

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. Expenditures should be for allowable activities in order to qualify as matching funds.

Federal Award Information: This finding impacts federal funding periods October 1, 2009 - September 30, 2010 and October 1, 2010 - September 30, 2011 (5NC300327).

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

Agency Response: The Department believes its revised internal controls and fiscal monitoring procedures effectively and adequately ensure subrecipients use state matching funds for allowable program activities. These revisions became effective in fiscal year 2011-12.

9. NONCOMPLIANCE WITH ADMINISTRATIVE MAINTENANCE OF EFFORT REQUIREMENT

The Department did not have controls in place to ensure that the federal maintenance of effort requirement for the administrative costs of the Career and Technical Education grant was met. Our audit revealed that administrative expenditures from non-federal sources in fiscal year 2011 were approximately \$139,000 less than those provided in fiscal year 2010.

Section 323(a) of the Carl D. Perkins Career and Technical Education Act of 2006 requires the State to provide from non-federal sources for state administration an amount that is not less than the amount provided in the preceding fiscal year.

The Department granted 34% of the grant to the North Carolina Community College System Office (NCCCS) during the year. The NCCCS' administrative costs are also used in the calculation to determine if the maintenance of effort requirement is met.

Although the Department reviewed its expenditures as well as those of the NCCCS on a quarterly basis to ensure compliance with this requirement, it did not request a waiver

AUDIT FINDINGS AND RESPONSES (CONTINUED)

when it became evident that the requirement would not be met. The Department provided \$60,000 and NCCCS provided \$79,000 less in 2011 than 2010.

Federal Award Information: This finding impacts federal funding period July 1, 2010 - September 30, 2011 (V048A100033A).

Recommendation: The Department should take action to ensure that the administrative maintenance of effort requirement is met in accordance with federal regulations or request a waiver.

Agency Response: The State of North Carolina continues to adequately support Career and Technical education during these difficult economic times. The Department will continue its quarterly review and monitoring of the maintenance of effort requirement. If the State is not going to meet the maintenance of effort and if the one time waiver has not been previously granted, the Department will request the waiver of this compliance requirement from the U.S. Department of Education.

10. INADEQUATE CONTROLS OVER DUNS NUMBER REQUIREMENT

The Department did not have effective controls to ensure Dun and Bradstreet Data Universal Numbering System (DUNS) numbers were obtained from subrecipients of the Twenty-First Century Community Learning Centers grant. Lack of effective controls resulted in the Department disbursing funds to subrecipients that did not have a DUNS number as required by federal regulations.

The Department maintained a central tracking sheet to ensure it obtained DUNS numbers from its non-ARRA subrecipients. However, the Department's central tracking sheet did not include 24 subrecipients that received Twenty-First Century funds. The division that administered those funds had not informed staff responsible for the tracking sheet that it was awarding funds to these subrecipients. The division had obtained DUNS numbers from 21 of the 24 subrecipients while collecting other information. As a result, the Department failed to obtain a DUNS number from three subrecipients that collectively received approximately \$102,000 in Twenty-First Century funds.

Title 2 CFR section 25.200 requires all subrecipients receiving non-ARRA first-tier subawards made on or after October 1, 2010 to provide a valid DUNS number to the awarding agency.

Federal Award Information: This finding impacts federal funding period July 1, 2010 - September 30, 2011 (S287C100033).

Recommendation: The Department should improve communication among its divisions to ensure all records are complete and a DUNS number is obtained from every non-ARRA subrecipient receiving funds on or after October 1, 2010.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Agency Response: The Department will ensure that the communication between the program staff and the fiscal Monitoring and Compliance Section is formalized so that all records are complete and DUNS numbers are obtained from every non-ARRA subrecipient receiving funds after October 1, 2010.

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:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

Facsimile: 919/807-7647