



# STATE OF NORTH CAROLINA

**DEPARTMENT OF PUBLIC INSTRUCTION**

**STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES**

**FOR THE YEAR ENDED JUNE 30, 2012**

**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, 2012**

**THE STATE BOARD OF EDUCATION**  
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Beth A. Wood, CPA  
State Auditor

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**AUDITOR'S TRANSMITTAL**

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The Honorable Pat McCrory, 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

As part of our audit of the State of North Carolina's compliance with requirements applicable to its major federal programs, we have completed certain audit procedures at the Department of Public Instruction for the year ended June 30, 2012. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*. We conducted the audit 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 State Auditor expresses an opinion on the State's compliance with requirements applicable to its major federal programs in the State's *Single Audit Report*.

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".

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**INDEPENDENT AUDITOR'S 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**

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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 could have a direct and material effect on each of its major programs for the year ended June 30, 2012, 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

**INDEPENDENT AUDITOR'S 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)**

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- CFDA 84.367: Improving Teacher Quality State Grants
- CFDA 84.287: Twenty-First Century Community Learning Centers
- CFDA 84.410: Education Jobs Fund
- CFDA 84.395: State Fiscal Stabilization Fund (SFSF)-Race-to-the-Top Incentive Grants, Recovery Act

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 finding 1 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.

**INDEPENDENT AUDITOR'S 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)**

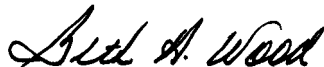
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*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, 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 finding 1 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 2 through 5 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 5, 2013

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## **AUDIT FINDINGS AND RESPONSES**

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

#### **1. DEFICIENCIES IN TWENTY-FIRST CENTURY SUBRECIPIENT MONITORING PROCESS**

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 \$35.6 million of Twenty-First Century Community Learning Centers funds.

Our review of 30 subrecipients' on-site monitoring files revealed the following deficiencies.

- The monitoring instrument contained compliance indicators, but there was no documentation demonstrating how the Department's staff determined that the indicators were met. The Department's monitoring procedures do not require the consultants to complete the supporting documentation unless an exception is identified.
- 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 its subrecipients for compliance with this requirement.
- There was no evidence of review or approval of the monitoring reports to ensure the reports clearly reflected the monitoring results.

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 to ensure that performance goals are achieved.

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

*Federal Award Information:* This finding impacts federal funding period July 1, 2011 - September 30, 2012 (S287C110033).

*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.

*Department Response:* The Department concurs with the Auditor's finding and recommendation. The Department's School Business Division's Monitoring and



## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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Compliance Section will work with federal program staff to update the monitoring tool to include the special test requirement relating to the participation of private school children. In addition, the Monitoring and Compliance Section will provide the federal program staff with assistance updating monitoring procedures to ensure appropriate documentation of all monitoring procedures performed, including those where indicators were met. Procedures will also be updated as necessary to ensure appropriate review and approval of monitoring reports in a timely manner. The Department plans to implement a process in which the Monitoring and Compliance Section will meet with federal program staff on a quarterly basis to verify all planned corrective action has been implemented and is being adhered to on a consistent basis.

### 2. INADEQUATE CONTROLS OVER DUNS NUMBER REQUIREMENT

As reported in the prior year, the Department did not have effective controls to ensure the Dun and Bradstreet Data Universal Numbering System (DUNS) numbers were obtained from subrecipients of the Twenty-First Century Community Learning Centers grant. The DUNS number is used by the Federal government generally to identify and track entities receiving Federal funds. The Department's lack of controls resulted in the Department disbursing funds to subrecipients that did not have a DUNS number.

The Department's current procedures require staff within the fiscal section to maintain a tracking spreadsheet to ensure DUNS numbers are obtained from its non-ARRA subrecipients. The division that administered the Twenty-First Century funds did not inform the fiscal section that funds were awarded to 37 subrecipients. The DUNS numbers were obtained from 34 of the 37 subrecipients while collecting other information. As a result, the Department failed to obtain a DUNS number from three subrecipients that collectively received \$97,140 in Twenty-First Century funds. Two of the three were reported in the prior year audit finding.

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, 2011 - September 30, 2012 (S287C110033).

*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.

*Department Response:* The Department concurs with the Auditor's finding and recommendation. The Department's School Business Division's Monitoring and Compliance Section will reiterate to program staff the requirement to obtain a DUNS number from every non-ARRA subrecipient receiving funds prior to funds being disbursed to them. Current procedures and tracking tools will be modified to ensure the Monitoring and Compliance Section staff responsible for maintaining the DUNS number

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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tracking spreadsheet receives positive confirmation from all divisions that they have provided fiscal staff with all appropriate DUNS numbers.

### 3. DEFICIENCIES IN TITLE I PROGRAM MONITORING

The Department did not have effective controls in place to ensure a monitoring report was provided to each subrecipient monitored and to ensure that corrective action was taken on all monitoring findings. As a result, there is an increased risk that noncompliance with federal requirements could continue if the subrecipient is not aware of the monitoring results and does not correct existing errors. Subrecipients received approximately \$400 million of Title I funds during the year.

Our review of the documentation for a sample of 12 on-site visits revealed the following deficiencies.

- The Department did not provide a monitoring report communicating the results of the visit to one subrecipient.
- One subrecipient did not submit a corrective action plan for the findings found during the monitoring visit.

The Department's current procedures require a monitoring log to be prepared for each subrecipient that shows the date the subrecipient was monitored, the date the monitoring report was sent to the subrecipient, and the date the corrective action plan was received that addressed all noncompliance issues. However, there was no review and approval to ensure the monitoring log is completed.

Federal regulations require the Department to monitor the activities of subrecipients as necessary to ensure that federal awards are used for authorized purposes in compliance with laws and regulations and ensure 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, 2010 - September 30, 2011 (S010A100033A); and 2) July 1, 2011 - September 30, 2012 (S010A110033A).
- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (S389A090033).

*Recommendation:* The Department should develop and implement effective procedures to ensure each subrecipient is monitored, receives a monitoring report, and takes corrective action on all findings.

*Department Response:* The Department concurs with the Auditor's finding and recommendation. The Department will develop and implement a tracking mechanism to help ensure timely, effective and complete monitoring of subrecipients. The tracking

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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mechanism will include the documentation of management reviews, comments, follow up dates and the status of the monitoring review or report. Verification of receipt of all required corrective action plans from subrecipients will also be documented within the developed tracking mechanism. In addition, the Department plans to implement a process in which the Monitoring and Compliance Section will meet with federal program staff on a quarterly basis to verify all planned corrective action has been implemented and is being adhered to on a consistent basis.

#### 4. CASH MANAGEMENT MONITORING 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 the Department and/or its subrecipients could accumulate federal funds and fail to disburse them in a timely manner. During the year, the Department disbursed approximately \$1.6 billion in federal funds to subrecipients for all grants.

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. In addition, 34 CFR section 80.20 requires the State to monitor cash drawdowns by its subrecipients to ensure 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. 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. 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.

The Department's year-end closeout process for the 2012 fiscal year revealed that excess funds had been drawn down and disbursed to subrecipients for a number of grants. The Department recovered these funds which caused the Department to have excess cash on hand. Examples noted are described below.

- The Department recovered \$7.7 million for the Special Education – Grants to State program on July 6, 2012.
- The Department recovered \$6.8 million for the Title I Cluster on July 11, 2012.
- The Department recovered \$1.7 million for the Improving Teacher Quality grant on July 6, 2012.

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

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

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

- a. Title I Grants to Local Education Agencies: Federal funding periods: 1) July 1, 2010 - September 30, 2011 (S010A100033A); and 2) July 1, 2011 - September 30, 2012 (S010A110033A).
- 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, 2009 - September 30, 2010 (H027A090092A); 2) July 1, 2010 - September 30, 2011 (H027A100092A); and 3) July 1, 2011 - September 30, 2012 (H027A110092-11B).
- d. Special Education - Preschool Grants: Federal funding periods: 1) July 1, 2009 - September 30, 2010 (H173A090096); 2) July 1, 2010 - September 30, 2011 (H173A100096); and 3) July 1, 2011 - September 30, 2012 (H173A110096).
- 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 (H392A090096).
- g. Improving Teacher Quality State Grants: Federal funding periods: 1) July 1, 2009 - September 30, 2010 (S367A090032A); 2) July 1, 2010 - September 30, 2011 (S367A100032A); and 3) July 1, 2011 - September 30, 2012 (S367A110032A).
- h. Twenty-First Century Community Learning Centers: Federal funding periods: 1) July 1, 2009 - September 30, 2010 (S287C090033); 2) July 1, 2010 - September 30, 2011 (S287C100033); and 3) July 1, 2011 - September 30, 2012 (S287C110033).
- i. Race to the Top: Federal funding period September 24, 2010 - September 23, 2014 (S395A100069).
- j. Education Jobs Fund: Federal funding period August 10, 2010 - September 30, 2011 (S410A100034).

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

*Department Response:* The Department concurs with the Auditor's finding and recommendation. In addition to zeroing out grant funds at the end of each month, the Department has updated fiscal monitoring procedures and the fiscal monitoring tool to include verification of subrecipients's compliance with federal and state cash management requirements. In an effort to improve monitoring of requested funds and actual disbursements the Department developed the Cash Management Monitoring System (CMMS). The system will assist fiscal monitors, LEAs and Charter Schools with

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

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monitoring cash management compliance. The Department anticipates the system's go live date to occur before March 31, 2013.

### **5. CORRECTIVE ACTION PLANS NOT OBTAINED FROM SUBRECIPIENTS**

The Department did not ensure subrecipients took timely corrective action on issues noted during the fiscal on-site monitoring visits. As a result, there is an increased risk that subrecipients may continue to be out of compliance in the areas noted during the monitoring visits.

Our review of 22 fiscal monitoring reports revealed that the Department had not received corrective action plans for five subrecipients. The Department's policy requests the subrecipient to respond to any need for corrective action within 30 business days. The Department indicated on its monitoring log that e-mails were sent to follow up with the subrecipients; however, responses had not been received. At the time of our audit, the corrective action plans for these five subrecipients were from 81 to 160 business days past due.

OMB Circular A-133 requires pass-through entities to monitor the subrecipients' use of Federal awards through reporting, site visits, regular contact and/or other means to provide reasonable assurance that the subrecipients administer Federal awards in compliance with laws and regulations. In addition, it requires pass-through entities to ensure subrecipients took appropriate and timely corrective action on its findings.

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

- a. School Breakfast Program, National Lunch Program, & Special Milk Program for Children: Federal funding periods: 1) October 1, 2010 - September 30, 2011 (5NC300327); and 2) October 1, 2011 - September 30, 2012 (5NC300327).
- b. Title I Grants to Local Education Agencies: Federal funding periods: 1) July 1, 2010 - September 30, 2011 (S010A100033A); and 2) July 1, 2011 - September 30, 2012 (S010A110033A).
- 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 periods: 1) July 1, 2009 - September 30, 2010 (H027A090092A); 2) July 1, 2010 - September 30, 2011 (H027A100092A); and 3) July 1, 2011 - September 30, 2012 (H027A110092-11B).
- e. Special Education - Preschool Grants: Federal funding periods: 1) July 1, 2009 - September 30, 2010 (H173A090096); 2) July 1, 2010 - September 30, 2011 (H173A100096); and 3) July 1, 2011 - September 30, 2012 (H173A110096).
- f. Special Education - Grants to States, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H391A090092A).

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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- g. Special Education - Preschool Grants, Recovery Act: Federal funding period February 17, 2009 - September 30, 2010 (H392A090096).
- h. Improving Teacher Quality State Grants: Federal funding periods: 1) July 1, 2009 - September 30, 2010 (S367A090032); 2) July 1, 2010 - September 30, 2011 (S367A100032); and 3) July 1, 2011 - September 30, 2012 (S367A110032).
- i. Education Jobs Fund: Federal funding period August 10, 2010 - September 30, 2011 (S410A100034).

*Recommendation:* The Department should ensure that the subrecipients take corrective action on all monitoring issues in a timely manner. The Department should consider modifying its current policy to include noncompliance remedies when subrecipients do not submit corrective action plans within the requested timeframe.

*Department Response:* The Department concurs with the Auditor's finding and recommendation. The Department will review and update existing fiscal monitoring policies to include noncompliance consequences for those subrecipients who do not submit requested corrective action plans within the time allotted. The original request and all follow up requests for corrective action plans will include notification of consequences for noncompliance.

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