

STATE OF NORTH CAROLINA

NORTH CAROLINA DEPARTMENT OF COMMERCE

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

NORTH CAROLINA DEPARTMENT OF COMMERCE

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2012

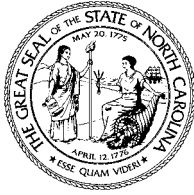
ADMINISTRATIVE OFFICERS

SHARON ALLRED DECKER, SECRETARY OF COMMERCE

DALE B. CARROLL, DEPUTY SECRETARY AND CHIEF OPERATING OFFICER

SHANNON HOBBY, CHIEF FINANCIAL OFFICER

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Beth A. Wood, CPA
State Auditor

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Mrs. Sharon Allred Decker, Secretary
Department of Commerce

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 Commerce 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*.

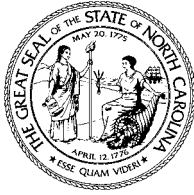
Our audit objective was to render an opinion on the State of North Carolina's, and not the Department's, administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole. The State Auditor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

Beth A. Wood, CPA
State Auditor



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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**

Secretary Sharon Allred Decker
and Management of the Department of Commerce

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 Commerce. 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 Commerce included the following:

- CFDA 17.225 – Unemployment Insurance
- Workforce Investment Act of 1998 (WIA) Cluster
 - CFDA 17.258 – WIA Adult Program
 - CFDA 17.259 – WIA Youth Activities
 - CFDA 17.260 and 17.278 – WIA Dislocated Worker Formula Grants
- Community Development Block Grant (CDBG) – State-Administered Small Cities Program Cluster
 - CFDA 14.228 – Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii
 - CFDA 14.255 – Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii – (Recovery Act Funded)
- CFDA 81.041 – State Energy Program
- CFDA 81.042 – Weatherization Assistance for Low-Income Persons

**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)**

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 Commerce disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described 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.

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


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THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR
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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, 2, 6, 8 and 9 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 3, 4, 5, 7, and 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, Secretary Decker, 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

Matters Related to Federal Compliance Objectives

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) - STATE-ADMINISTERED SMALL CITIES PROGRAM CLUSTER - CFDA 14.228 AND 14.255

1. LACK OF SEGREGATION OF DUTIES IN THE ADMINISTRATION OF GRANTS MANAGEMENT SYSTEM

The Department did not properly segregate duties for the administration of the Grant Management System (GMS). As a result, there is an increased risk that data integrity could be compromised and noncompliance with federal regulations could occur.

Duties for production and programming of the GMS are not separated. Instead, a single individual is responsible for all duties related to the system. A review is not conducted by an alternate person after changes to the database and programs have been implemented. Also, there are no formal procedures to identify needed maintenance and updates, emergency changes, and incident handling.

The *Statewide Information Security Manual* states that agency management must ensure that there is proper segregation of duties to reduce the risk of agency system misuse and fraud. In addition, the manual states that system development and system change management shall be performed by different personnel, and system operations and system security administration shall be performed by different personnel.

This finding was also reported in the prior year.

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-09-DC-37-0001 awarded January 1, 2009; award B-08-DC-37-0001 awarded January 1, 2008; and award B-07-DC-37-0001 awarded January 1, 2007 and CFDA 14.255 Community Development Block Grant (Recovery Act Funded) award B-09-DY-37-0001 for the award period of June 15, 2009 - September 30, 2012.

Recommendation: The Department should adequately segregate duties for the administration of the Grant Management System.

Agency Response: Due to budget constraints, the ability to employ additional staff is not feasible at this time. Our agency will look at additional ways within budgetary means to address segregation of duties concern.

- A system of Program Change Request is in place which allows users to formally request changes or report deficiencies to management.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- A verification step has been added which requires management to verify that the data is consistent after the changes are made.
- Employee access to the GMS system is to be reviewed on a semi-annual basis.
- Employee access is granted after formal approval by the Director.

Anticipated Completion Date: Completed Prior to March 15, 2013

2. DEFICIENCIES IN FEDERAL REPORTING

The Department submitted Community Development Block Grant (CDBG) reports to the federal agency that were misstated. During our test of the federal reports, we noted the following errors and internal control deficiencies:

- The Department did not adequately review the data or supporting documentation to ensure the accuracy of the information in the 2011 CDBG Performance and Evaluation Report prior to its submission. Errors occurred in the calculation of total funds used for National Objectives, resulting in the total funds reported being understated by \$289,569.
- The Department did not report the Commerce Finance Center revolving loan fund balance of \$5,437,983 in either the federal Integrated Disbursement Information System or the Performance Evaluation Report, as required by federal reporting requirements.
- While testing documentation supporting the annual *Section 3 Summary Report*, we reviewed a sample of 60 subrecipient Annual Performance Reports and found errors in the review and reporting of data for 17 subrecipients. Each of these 17 subrecipients had one or more of the following types of errors: no review and approval of supporting documentation, lack of documentation to support amounts reported, subrecipients' data not reported, or discrepancies between supporting documentation and the amount reported in the Section 3 Summary sheet. As a result, not all activity was included in the annual report submitted to HUD.
- The Department is in noncompliance with reporting requirements under the Federal Funding Accountability and Transparency Act (FFATA). It failed to report any CDBG sub-awards of \$25,000 or more, as required, in the FFATA Subaward Reporting System.

Aspects of this finding were reported in the prior two years.

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-09-DC-37-0001 awarded January 1, 2009; award B-08-DC-37-0001 awarded January 1, 2008; and award B-07-DC-37-0001 awarded January 1, 2007 and CFDA 14.255 Community Development

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Block Grant (Recovery Act Funded) award B-09-DY-37-0001 for the award period of June 15, 2009 - September 30, 2012.

Recommendation: The Department should strengthen internal controls to ensure reports are prepared in accordance with federal reporting requirements.

Agency Response:

- a. The error was caused by an incorrect formula that was used in the allocation of funds by National Objective. In the design of the report, the formula referenced a different column on the same page. This was corrected and a revised report was produced which will be submitted to the U.S. Department of HUD.

Anticipated Completion Date: Completed Prior to March 15, 2013

- b. The Commerce Finance Center and the Division of Community Assistance have been working with the Greensboro Area Office of the U.S. Department of Housing and Urban Development (HUD) to enter the revolving loan fund data into the federal Integrated Disbursement Information System (IDIS). Awards from the revolving loan fund will be included as a part of the Annual Performance Evaluation Report to HUD.

Anticipated Completion Date: July 1, 2013

- c. The Compliance Section has implemented procedural changes to correct these issues. The section will have one person entering the data and another person verifying that the data was entered correctly. That person will also verify that all of the data was captured.

The documents are now reviewed by at least three to four people, whereas previously, the information was reviewed by one person.

Anticipated Completion Date: Completed Prior to March 15, 2013

- d. Staff is now working with HUD to have all data entered to bring NC in compliance. Technical errors in the federal reporting system have since been, or are being, corrected to allow data entry in compliance with FFATA.

Anticipated Completion Date: July 1, 2013

WORKFORCE INVESTMENT ACT OF 1998 (WIA) CLUSTER - CFDA 17.258, 17.259 AND 17.278

3. DEFICIENCIES IN SUBRECIPIENT MONITORING

The Department did not document that monitoring procedures were performed to ensure that data for all participants receiving Workforce Investment Act (WIA) Cluster funds was included in the Workforce Plus system. This system is used to track and evaluate WIA performance for federal reporting purposes. Without effective monitoring procedures, there is an increased risk federal reports may not contain all activity of the period.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Division of Workforce Solutions (DWS) Workforce Investment Act Oversight & Review Guide requires DWS financial and programmatic monitors to verify that participants enrolled in WIA were entered into Workforce Plus. During our review of five local area monitoring visits, none of the five monitoring files included evidence that the reconciliations of participants between the Workforce Plus and the local area's participant expense accounting system were completed and reviewed by the monitors.

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 grant agreements and to ensure that performance goals are achieved. This monitoring should include ensuring that all activity is reported by the subrecipients to be included in the pass-through entities federal performance reports.

Federal Award Information: This finding affects the following:

- CFDA 17.258 WIA Adult Program award AA-18653-09-55-A-37 for the award period July 1, 2009 - June 30, 2012, award AA-20205-10-55-A-37 for the award period July 1, 2010 - June 30, 2013 and award AA-21407-11-55-A-37 for the award period July 1, 2011 - June 30, 2014.
- CFDA 17.259 WIA Youth Activities award AA-18653-09-55-A-37 for the award period April 1, 2009 - June 30, 2012, award AA-20205-10-55-A-37 for the award period April 1, 2010 - June 30, 2013 and award AA-21407-11-55-A-37 for the award period April 1, 2011- June 30, 2014.
- CFDA 17.260 WIA Dislocated Workers award AA-18653-09-55-A-37 for the award period July 1, 2009 - June 30, 2012, award AA-20205-10-55-A-37 for the award period July 1, 2010- June 30, 2012, and award AA-21407-11-55-A-37 for the award period July 1, 2011 - June 30, 2014.
- CFDA 17.278 WIA Dislocated Workers award AA-20205-10-A-37 for the award period July 1, 2010 - June 30, 2013 and award AA-21407-11-A-37 for the award period July 1, 2011 - June 30, 2014.

Recommendation: The Department should ensure that all necessary monitoring procedures are performed and documented, including procedures to ensure that participant data is properly included in the Workforce Plus system.

Agency Response: Division staff performing both programmatic and financial monitoring routinely reconciles payments made to and on behalf of WIA participants. The process will be strengthened in the subrecipients' local accounting systems and with WorkforcePlus. Additional questions will be added to the WIA Oversight Review Guide, the monitoring instrument used for the annual on-site reviews of subrecipients. Also, an additional question will be added concerning the subrecipients' local process of reconciliation of WIA participant information among those data sources.

Anticipated Completion Date: Completed Prior to March 15, 2013

AUDIT FINDINGS AND RESPONSES (CONTINUED)

UNEMPLOYMENT INSURANCE – CFDA 17.225

4. DEFICIENCIES IN BENEFIT INTEGRITY'S PROCESSING AND MONITORING OF OVERPAYMENT INVESTIGATIONS

The Department's Division of Employment Security Benefit Integrity section (formerly Benefit Payment Control) has not been able to investigate and adjudicate potentially inappropriate benefit payments timely. Lack of timely investigation impacts the ability to recover and/or prevent overpayments.

The Benefit Integrity (BI) section's cases, with potential overpayments due to both fraud and error, result from a weekly cross-match with the National Directory of New Hires database and other tips and leads. The Benefit Audit, Reporting, and Tracking System (BARTS) and the Inventory Tracking System are used to document these potential overpayments and completed case investigations. The BARTS continues to have limitations in its reporting and case management capabilities. Currently, the Division is unable to provide a report or to query the tracking system to identify the total number of cases/items that have been opened but remain unassigned.

The weekly cross-match of new hires against claims paid for the week produces 625 potential overpayment cases to investigate per week (32,500 per year). Not all of these matches result in identified overpayments, but all must be assessed for potentially improper payments. The Division has indicated that there are over 16,000 cases in the backlog of assigned but not closed cases. This backlog doesn't consider the number of cases that have not been assigned for investigation. The BI section has 25 staff to investigate and adjudicate these cases. Based on case closures reported, the average number of cases closed per quarter by the BI section is 1,372 cases. This indicates that it would take almost three years to eliminate the backlog with current staff levels.

Unemployment Insurance Program Letter 19-11A, Improper Payments, indicates that integrity programs must be designed to discourage fraud and uncover potential issues of fraud at the earliest possible time. Also, the Division's internal policy indicates that cases should be worked and completed within 90 days of assignment to ensure timely action on potential fraudulent claims.

During our review of the BARTS report of cases closed during the 2012 state fiscal year, we identified several concerns related to the time between the date the potential overpayment item was opened, assigned, and closed with final resolution. The opened date is the date the item is entered in BARTS and thereby identified as a potential improper payment. The following items were noted in our sample of 60 closed cases:

- There were 35 cases in which the number of days from the opened date to the closed date exceeded 90 days, 13 of which were over one year. The oldest item was closed 904 days after opening.
- Twenty-five cases exceeded 90 days from the opened date to the date the item was assigned for investigation, 11 of which were over one year.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- Three cases were not closed within 90 days of being assigned to the adjudicator.

Additionally, we identified several cases from 2009 that still remained open. Upon further inspection, some of these older cases had been completed but were documented in the Inventory Tracking System and were never closed in BARTS. No reconciliation is performed between the two systems to ensure that all cases are properly closed and the status is consistent between the systems.

Federal Award Information: Unemployment Insurance - funding from the State and Federal Unemployment Trust Funds. This finding affects funds administered under the American Recovery and Reinvestment Act.

Recommendation: The Department should evaluate its business processes and staffing plan to ensure the timely investigation of potential overpayment cases. Investigations should be completed in a manner that allows for effectively recouping overpayments and preventing continued overpayments. The Department should also continue working with the vendor to enhance the reporting and data querying capabilities within BARTS. The system should be able to provide management easily usable information needed to monitor the progress of potential overpayment investigations.

Agency Response: Due to the increase in unemployment claims as a result of this unprecedented recession, the Division of Employment Security identified more than 20,000 cases for investigation and/or review for potential inappropriate benefit payments. The Division has implemented controls to detect potential unemployment fraud cases as required by the United States Department of Labor (USDOL). However, adjustments to the existing business processes were made after the fiscal year end to handle the excessive caseload brought on by the increase in unemployment claims. As a result, the Division of Employment Security has hired six additional investigators, thus the backlog was reduced from in excess of 20,000 cases to 16,000 cases within this audit period.

Subsequent to year-end, the Division has also implemented an automated system to detect and reduce the risk of fraud via overpayments through the National Directory of New Hire (NDNH) claim interruption process; which lessens any timeliness concerns and strengthens the existing business process. Those claimants identified through the weekly NDNH return to work process are mailed notice to make contact with the Division of Employment Security because the cross match hit indicated that they are receiving unemployment benefits while potentially having active employment. The claims of those individuals who fail to make timely contact are interrupted. Thereby, allowing Division management to more effectively and efficiently address the case backlog and the auditor's concerns.

Anticipated Completion Date: March 31, 2013

AUDIT FINDINGS AND RESPONSES (CONTINUED)

5. CONTROLS OVER SYSTEM ACCESS NEED IMPROVEMENT

The Department has granted an excessive number of personnel the authority to use critical update transaction codes in the unemployment benefit system. According to the principle of least privilege, users should only be granted the minimal amount of access rights necessary to execute their responsibilities, thus limiting the risk of improper changes being made that result in benefit payment errors.

We reviewed the personnel authorized to use critical update transaction codes and identified users with questionable business needs for the codes. For example, members of upper management and personnel outside the unemployment claims benefit processing group had the authority to use the codes.

These transaction codes may be used to make changes that impact claims, such as the weekly benefit amount. Improper use of these critical update transactions have contributed to overpayments, such as duplicate payments, incorrect weekly benefit amounts, and ineligible additional weeks of benefits.

The State of North Carolina Statewide Information Security Manual, Section 020101, states that access shall be controlled and managed to ensure that only authorized persons have access as is appropriate for an agency in accordance with the agency's business needs. Additionally, the manual states that only authorized users shall be granted access at the level of least privileges required by their job function.

Federal Award Information: Unemployment Insurance - funding from the State and Federal Unemployment Trust Funds. This finding affects funds administered under the American Recovery and Reinvestment Act.

Recommendation: The Department should evaluate the access privileges within the unemployment insurance benefit system and determine if unnecessary privileges have been granted based on identified business needs. Additionally, the Department should continue monitoring the use of critical update transaction codes on a regular basis to ensure that errors related to improper transaction code use are detected and claimants receive the correct amount of benefits.

Agency Response: At the time users were granted system access to critical transactions, the users had a business need for this access. However, due to promotions and realignment of positions, some user's access should now be removed to align with current job functions. On a quarterly basis, the DES management reviews access to ensure that users have the appropriate access for their job duties. The population selected for review occurred before a quarterly review, this may have contributed to the non-revocation of these users access.

DES has a controlled process in place to review user access to critical transactions prior to granting access to these transactions. Access request to UI transactions are submitted to the UI Data Owner for review by a user's supervisor along with a justification for

AUDIT FINDINGS AND RESPONSES (CONTINUED)

access. The UI Data Owner reviews the request and justification and makes a determination whether the user should be allowed access to the requested transactions. Additionally, DES processes more than 800,000+ claims a year. Therefore, the number of DES staff with access to critical update transactions is significant, as majority of our staff is involved in claims processing. DES will continue to review access privileges for access to UI transactions and monitor the use of critical update transactions to ensure that staff has only the access needed to perform their job duties.

Anticipated Completion Date: Completed Prior to March 15, 2013

WEATHERIZATION ASSISTANCE FOR LOW-INCOME PERSONS - CFDA 81.042

6. DEFICIENCIES IN CASH MANAGEMENT

The Department of Commerce did not comply with federal and state cash management requirements for the Weatherization Assistance for Low-Income Persons program. The *OMB Circular A-133 Compliance Supplement* requires the State to minimize the time elapsing between its receipt of funds from the U.S. Treasury and the disbursement of those funds. *North Carolina General Statute 147-86.11 (f.3)* and the State's cash management policy require that federal program expenditures initially paid from state funds be reimbursed immediately with federal funds.

We analyzed the population of Weatherization grant payments to subrecipients and the corresponding federal cash draws that were processed by the Department. For the 2,757 American Recovery and Reinvestment Act (ARRA) Weatherization payment requests and 1,425 regular Weatherization payment requests, we noted the following deficiencies:

- For 824 ARRA payments to subrecipients valued at \$4.3 million and 200 regular Weatherization payments to subrecipients valued at \$298,560, the funds were drawn from the federal agency four to 20 and four to 19 working days, respectively, before they were disbursed to subrecipients. Therefore, the Department did not comply with federal requirements to minimize the time elapsing between draw down of funds and disbursement to subrecipients.
- For 42 ARRA payments to subrecipients valued at \$695,700 and 587 regular Weatherization payments to subrecipients valued at \$762,084, the funds were drawn from the federal agency four to 12 and four to 28 working days, respectively, after the Department paid the subrecipients. Therefore, funds used to pay the subrecipients were not promptly reimbursed in accordance with state requirements. However, for these subrecipient payments, it is unclear whether the funds used for the payments were from state funds or other federal programs. We noted that the account used to make the Weatherization payments included deposits from other federal grants, such as the Workforce Investment Act (WIA) Cluster, the State Energy Program ARRA, and others.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

This finding was also reported in the prior two years.

Federal Award Information: This finding affects CFDA 81.042 Weatherization Assistance for Low-Income Persons award DE-FG26-07NT43134 for the award period July 1, 2007 - June 30, 2012 and ARRA award DE-EE0000118 for the award period April 1, 2009 - June 30, 2013.

Recommendation: The Department should strengthen procedures to ensure that federal funds are drawn and disbursed in accordance with federal and state cash management requirements.

Agency Response: The Fiscal Management Division has implemented additional internal controls to minimize problems with the Cash Management Improvement Act, CMIA. The division has split administrative expenses from sub-grantee payments. In addition, the administrative draws are done separately from the sub-grantee draws. The division also noticed that periodically refunds from sub-grantee recipients had caused the draw to be less than the expenses that were to be paid. To ensure that matching was occurring, the division has added a policy to document the refunds in the draw log record to show why the funds drawn were less than the payments made.

Anticipated Completion Date: Completed Prior to March 15, 2013

7. SUBRECIPIENT MONITORING NEEDS IMPROVEMENT

The Department of Commerce did not have procedures in place to ensure that the subrecipients in the Weatherization Assistance for Low-Income Persons program and funded by American Recovery and Reinvestment Act (ARRA) moneys were registered in the Central Contractor Registration (CCR) database. The Department also did not perform periodic reviews to ensure that subrecipients were updating the information. This results in an increased risk of noncompliance with the federal requirements; however, we found only one subrecipient without a current CCR registration.

We reviewed the CCR registration status for six Weatherization subrecipients and found that one had a CCR registration that expired on January 5, 2012.

The *OMB Circular A-133 Compliance Supplement* states that a pass-through entity is responsible for identifying to first-tier subrecipients the requirement to register in the Central Contractor Registration, including obtaining a Dun and Bradstreet Data Universal Numbering System (DUNS) number, and for maintaining the currency of that information. The supplement further requires that the State monitor compliance with applicable compliance requirements.

Federal Award Information: This finding affects CFDA 81.042 Weatherization Assistance for Low-Income Persons ARRA award DE-EE0000118 for the award period April 1, 2009 - June 30, 2013.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should strengthen internal controls to ensure that subrecipients have a valid CCR registration, as required.

Agency Response: The Department now requires each subrecipient to submit current CCR information with subrecipient's annual application.

Anticipated Completion Date: July 1, 2013

STATE ENERGY PROGRAM - CFDA 81.041

8. DEFICIENCIES IN CASH MANAGEMENT

The Department of Commerce did not comply with federal and state cash management requirements for the State Energy Program (Energy) program. The *OMB Circular A-133 Compliance Supplement* requires the State to minimize the time elapsing between its receipt of funds from the U.S. Treasury and the disbursement of those funds. *North Carolina General Statute 147-86.11 (f.3)* and the State's cash management policy require that federal program expenditures initially paid from state funds be reimbursed immediately with federal funds.

We analyzed the population of Energy program payments to subrecipients and the corresponding federal draws that were processed by the Department. For the 2,686 American Recovery and Reinvestment Act (ARRA) payment requests and 820 regular Energy program payment requests, we noted the following deficiencies:

- For 638 ARRA payments to subrecipients valued at \$4.5 million and 392 regular Energy payments to subrecipients valued at \$198,062, the funds were drawn from the federal agency four to 14 and four to 26 working days, respectively, before they were disbursed to subrecipients. As a result, the Department did not comply with federal requirements to minimize the time elapsing between draw down of funds and disbursement to subrecipients.
- For 71 ARRA payments to subrecipients valued at \$4.2 million and 115 regular Energy program payments to subrecipients valued at \$300,046, the funds were drawn from the federal agency four to five and four to 25 working days, respectively, after the Department paid the subrecipients. As a result, funds used to pay the subrecipients were not reimbursed promptly in accordance with state requirements. However, for these subrecipient payments, it is unclear whether the funds used for the payments were from state funds or other federal programs. We noted that the account used to make the Energy payments included deposits from other federal grants, such as the Workforce Investment Act (WIA) Cluster, the Weatherization Program ARRA, and others.

Federal Award Information: This finding affects CFDA 81.041 State Energy Program award DE-EE0003881 for the award period July 1, 2010 - June 30, 2012 and ARRA award DE-EE0000157 for the award period April 20, 2009 - October 31, 2012.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should strengthen procedures to ensure that federal funds are drawn and disbursed in accordance with federal and state cash management requirements.

Agency Response: The Fiscal Management Division has implemented additional internal controls to minimize problems with the Cash Management Improvement Act, CMIA. The division has split administrative expenses from sub-grantee payments. In addition, the administrative draws are done separately from the sub-grantee draws. The division also noticed that periodically refunds from sub-grantee recipients had caused the draw to be less than the expenses that were to be paid. To ensure that matching was occurring, the division has added a policy to document the refunds in the draw log record to show why the funds drawn were less than the payments made.

Anticipated Completion Date: Completed Prior to March 15, 2013

9. SUBRECIPIENT MONITORING NEEDS IMPROVEMENT

The Department of Commerce did not adequately monitor subrecipients in the State Energy Program. The *OMB Circular A-133 Compliance Supplement* requires primary recipients to include certain information in the subrecipient award notification, conduct during-the-award monitoring, and receive and follow up on subrecipient audit reports within prescribed timeframes.

Award Notification

The Department did not consistently communicate the Catalog of Federal Domestic Assistance (CFDA) number to each subrecipient at the time of the award of American Recovery and Reinvestment Act (ARRA) moneys as required. While testing the ARRA award documents, we reviewed a sample of 35 subrecipients and noted that the federal award number and the amount of ARRA funds were included in the award documents; however, the CFDA number was not included in 19 of the subrecipient award documents. Without the necessary information, subrecipients cannot properly identify the ARRA awards and expenditures in their Schedule of Expenditures of Federal Awards and Data Collection Form.

We also noted that subrecipient audit requirements were not communicated at the time of the award to five of the 35 ARRA funds recipients that we examined.

The *OMB Circular A-133 Compliance Supplement* requires the State to separately identify to each subrecipient, and document at the time of the subaward, the federal award number, CFDA number, and the amount of ARRA funds; and require their subrecipients to provide similar identification in their Schedule of Expenditures of Federal Awards and Data Collection Form. The supplement also requires the State, at the time of the award, to identify to the subrecipient the applicable compliance requirements, which include audit requirements.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

During-the-Award Monitoring

The Department did not ensure that subrecipients funded by ARRA moneys were registered in the Central Contractor Registration (CCR) database at the time of the award and did not perform periodic reviews to ensure subrecipients updated the information when necessary. We reviewed the CCR database for 35 of the 175 subrecipients and found that two subrecipients had Data Universal Numbering System (DUNS) numbers in the CCR database that had expired.

The *OMB Circular A-133 Compliance Supplement* states that a pass-through entity is responsible for identifying to first-tier subrecipients the requirement to register in the Central Contractor Registration, including obtaining a Dun and Bradstreet Data Universal Numbering System (DUNS) number, and for maintaining the currency of that information. The supplement further requires that the State monitor compliance with applicable compliance requirements.

Subrecipient Audit Reports

The Department does not have a tracking mechanism in place to ensure that required audit reports are received and management decisions on audit findings are issued timely. We also noted that the Department does not review subrecipients' Schedules of Expenditures of Federal Awards and Data Collection Forms to determine if ARRA funding is reported separately.

The *OMB Circular A-133 Compliance Supplement* requires pass-through entities to ensure subrecipients who expend \$500,000 or more in federal awards during the subrecipients' fiscal year have an audit completed within nine months after the end of the subrecipients' audit period. The pass-through entity is also required to issue management decisions on audit findings within six months after the receipt of the subrecipient's audit report and ensure the subrecipient takes timely and appropriate action on all findings. The supplement also requires subrecipients to separately account for ARRA funds and separately identify the funds in their Schedule of Expenditures of Federal Awards and Data Collection Form.

Federal Award Information: This finding affects CFDA 81.041 State Energy Program award DE-EE0003881 for the award period July 1, 2010 - June 30, 2012 and ARRA award DE-EE0000157 for the award period April 20, 2009 - October 31, 2012.

Recommendation: The Department should strengthen its subrecipient monitoring procedures to ensure that all necessary information is communicated at the time of the award; subrecipients comply with applicable requirements during period the award is used; required information is included in subrecipients' Schedules of Expenditures of Federal Awards and Data Collection Forms; and audit reports are received when necessary and timely action is taken on reported audit findings.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: Effective January 2012, the Department implemented controls to ensure that subrecipients receive the CFDA number and all audit and compliance requirements at the initial award. The Department requires all subrecipients to have active CCR registration from the time of award throughout the grant. The DUNS numbers are checked at initial award to ensure that they are active. Effective September 2012, the department developed internal controls to ensure that DUNS numbers are active in CCR registration database throughout the entire grant. Effective February 2013, the Department assigned business officers to ensure that audit reports are received from all subrecipients. Business officers review the reports and submit to managers for review and a management decision is issued on any audit findings within six months.

Anticipated Completion Date: Completed Prior to March 15, 2013

10. DEFICIENCIES IN FEDERAL REPORTING

For the State Energy Program, the Department of Commerce did not have adequate controls in place to ensure compliance with federal reporting requirements. As a result, there is an increased risk that federal reports could contain errors and not be detected and corrected timely by the Department.

During our test of the federal reports, we noted the following deficiencies:

- The Department did not adequately review the data or supporting documentation to ensure accuracy of the information in the regular program Performance Report prior to its submission. As a result, the expenditures reported were overstated by \$18,508 for the period ended December 31, 2011.
- The Department did not adequately review the data or supporting documentation to ensure accuracy of the information in the American Recovery and Reinvestment Act (ARRA) Performance Report prior to its submission. As a result, the expenditures in the report were overstated by \$48,761 for the period ended December 31, 2011.
- The Department did not adequately review the data or supporting documentation to ensure accuracy of the information in the Section 1512 ARRA report prior to its submission. As a result, total ARRA expenditures and total ARRA receipts reported were overstated by \$93,791 for the period ended March 31, 2012.
- The regular program SF-425 report for the period ended March 31, 2012 was not reviewed and approved by the appropriate management personnel prior to submitting the report. Although there were no errors noted, the absence of proper controls increases the risk that the report may be incomplete or contain errors.

As required by the *OMB A-133 Compliance Supplement*, the recipients of federal awards are expected to have controls in place to ensure compliance with the following federal reporting requirements: reports for federal awards are required to include all activity of

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

the reporting period, be supported by applicable accounting or performance records, and be fairly presented in accordance with program requirements.

Federal Award Information: This finding affects CFDA 81.041 State Energy Program award DE-EE0003881 for the award period July 1, 2010 - June 30, 2012 and ARRA award DE-EE0000157 for the award period April 20, 2009 - October 31, 2012.

Recommendation: The Department should strengthen internal controls to ensure reports are complete and accurate.

Agency Response: An internal control procedure has been implemented requiring the data and supporting documentation to be reviewed and reconciled to the Certified BD-701 prior to submission. Management reviews and approves all SF-425s before the reports are submitted to DOE. These controls were implemented February 2013.

Anticipated Completion Date: Completed Prior to March 15, 2013

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
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Telephone: 919/807-7500

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