

STATE OF NORTH CAROLINA

NORTH CAROLINA DEPARTMENT OF COMMERCE

RALEIGH, NORTH CAROLINA

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

NORTH CAROLINA DEPARTMENT OF COMMERCE

RALEIGH, NORTH CAROLINA

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

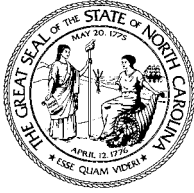
FOR THE YEAR ENDED JUNE 30, 2013

ADMINISTRATIVE OFFICERS

SHARON ALLRED DECHKER, SECRETARY OF COMMERCE

SHANNON HOBBY, CHIEF FINANCIAL OFFICER

**KEVIN CARLSON, CHIEF FINANCIAL OFFICER, DIVISION OF
EMPLOYMENT SECURITY**



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
Ms. Sharon Allred Decker, Secretary
North Carolina 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 North Carolina Department of Commerce for the year ended June 30, 2013. 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*.

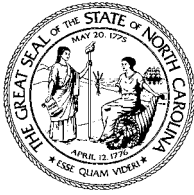
Our audit objective was to render an opinion on the State of North Carolina's, and not the Department's, administration of major federal programs. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole. The State Auditor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

Report on 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, 2013, we have performed audit procedures at the North Carolina 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 North Carolina 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 17.278 – 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)

**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.

Management's Responsibility

Management is responsible for compliance with laws, regulations, contracts, and grants applicable to federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the State of North Carolina's major federal programs based on our audit of the types of compliance requirements referred to above, which we issue in the State's *Single Audit Report*. 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. However, our audit does not provide a legal determination of the Department's compliance with those requirements.

Opinion on Each Major Federal Program

As stated above, our opinion on compliance for each of the State of North Carolina's major federal programs is included in the State's *Single Audit Report*.

Other Matters

The results of our audit procedures at the North Carolina 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 findings 3, 4, and 8 in the Audit Findings and Responses section of this report.

**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)**

Report on Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered internal control over compliance with the types of requirements that could have a direct and material effect on a major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 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 material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we consider the deficiencies described in findings 1 - 6 in the Audit Findings and Responses section of this report to be material weaknesses in internal control over compliance. Furthermore, we consider the deficiencies described in findings 7 - 9 in the Audit Findings and Responses section of this report to be significant deficiencies in 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)**

Purpose of Report on Internal Control Over Compliance

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this communication is not suitable for any other purpose.

Management's Responses to Audit Findings

Management's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. The responses were not subjected to the auditing procedures applied in the audit of compliance or consideration of internal control over compliance, and accordingly, we express no opinion on them.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 14, 2014

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

1. MANAGEMENT'S IMPLEMENTATION OF CORRECTIVE ACTION WAS INADEQUATE

The Department of Commerce management has not ensured implementation of corrective action on all prior year audit findings for three major federal programs audited for fiscal year ended June 30, 2013. Failure to timely implement corrective action to ensure compliance allows federal funds to potentially be used for unallowable expenditures or fail to be properly reported to the federal oversight agency.

Four of the eight findings below for 2013 repeat aspects of findings from the prior years. Although, the Department had identified corrective action plans to address these areas in prior years, there has been a breakdown in the implementation of those corrective actions to prevent further issues.

Here are some of the details:

- The failure to segregate duties for maintaining and operating the Grants Management System (GMS) for the Community Development Block Grant program has contributed to findings related to both federal reporting and earmarking compliance requirements. Department information system staff, who are unfamiliar with the system, have been trying to provide the needed data and reports for program staff. However, success has been limited and the auditors have been unable to rely on data from the system.
- A backlog of investigative cases for potential benefit overpayment in the Unemployment Insurance program continued. In prior year the backlog was over 16,000 assigned cases, but during 2013 was only decreased to near 14,000 cases. Additionally, the timeliness of case closure has not significantly improved.
- The procedures for performing subrecipient monitoring for the Workforce Investment Act Cluster were not updated in accordance with the prior corrective action plan. The monitoring procedures did not provide evidence that all participants receiving services from the program are being documented in the Workforce Plus System. This system is used to generate performance reports to demonstrate that use of federal funds is meeting the expected performance goals for serving participants.

OMB Circular A-133 section .300 requires that auditees, State agency, maintain internal control over federal programs to ensure compliance federal regulations. It further states that auditees are responsible for following up and taking corrective action for audit findings.

Also, North Carolina General Statute 143D, *State Government Accountability and Internal Control Act*, provides that each State agency is fully responsible for establishing

AUDIT FINDINGS AND RESPONSES (CONTINUED)

and maintaining a proper system of internal controls. The Office of the State Controller requires State agencies to make satisfactory progress in resolving deficiencies in internal control determined by any internal or external auditor of the agency. If the State Controller determines deficiencies are not being resolved in a reasonable period after the audit report date, the State Controller may recommend disciplinary action after consultation with the State Auditor.

Federal Award Information: This finding affects the following programs and awards:

CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded April 4, 2012; award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-9-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.

CFDA 17.258 WIA Adult Program, CFDA 17.259 WIA Youth Activities, and CFDA 17.278 WIA Dislocated Workers awards AA-20205-10-55-A-37 for the award period July 1, 2010 - June 30, 2013, AA-21407-11-55-A-37 for the award period July 1, 2011 - June 30, 2014 and AA-22947-12-55-A-37 for the award period July 1, 2012 - June 30, 2015.

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 and Division management should ensure that appropriate follow-up on audit findings is performed. Follow-up should include well defined corrective action plans, establishment of deadlines for implementation of the plan and identification of individuals responsible for implementation.

Management Response: The Department acknowledges its failure to ensure proper implementation of corrective action plans for past audits. These prior findings occurred during the previous administration, but the Department has new leadership in place and is committed to ensuring that all corrective action plan items for this and previous audits are completed.

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

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

The Department of Commerce's Division of Community Assistance 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.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Duties for production¹ 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 another person after changes to the database and programs have been implemented to ensure accuracy. The GMS system is used to track and maintain all grant data² for over 400 subawards, which may include multiple awards to the same subrecipient. The Department disbursed approximately \$50 million during the 2013 fiscal year to subrecipients.

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.

Additionally, in April 2013, the individual responsible for maintaining and operating the GMS left the Department and the position has not been filled as of February 2014. The Department does not have other personnel knowledgeable of the system operation and queries to generate accurate data for federal reporting and to ensure compliance with federal requirements.

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

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded April 4, 2012; award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-9-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.

Recommendation: The Department should adequately segregate duties for the administration of the Grant Management System. Also, the Department should ensure that knowledgeable staff is put in place to maintain and operate the Grants Management System.

Management Response: DCA's current grants management system is a proprietary software program that was built and modified by a single individual since its inception, and that individual is no longer employed by the Department. The system uses non-standard database programming techniques and has now become almost impossible to manage and extract data. As a result, the Department has submitted a budget expansion request to the Office of State Budget and Management (OSBM) to receive additional funds to purchase and install a new grants management software program.

¹ Production includes the creation of annual federal reports, maintaining on-line queries for users to generate periodic reports for monitoring and keeping the system operating.

² Grant data is all data associated with subrecipients and includes name, address, contact information, grant number, grant amount, grant agreement date, budget, requisitions, expenditures, project type, open/close dates, monitoring visit dates, etc. This data includes life to date information for all subawards made as far back as 2001.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

In addition, a comprehensive plan is currently under development regarding the Grants Management System (GMS) that will:

- a. Identify the weaknesses of the system and establish new temporary operational procedures to ensure proper segregation of duties and data integrity;
- b. Develop a hiring plan to ensure the proper segregation of duties and workload regarding the grants management solution;
- c. Develop a plan and timeline to adopt a new out-of-the-box (non-proprietary) grant management software solution;
- d. Verify the validity of the current GMS data and make corrections using formalized change management procedures;
- e. Migrate the GMS data to the new grant management software solution; and
- f. Develop a set of formalized policies and procedures regarding proper segregation of duties, data validation, staff training, and system security, and maintenance.

DCA will develop and adopt a set of formal policies and procedures that will ensure the proper segregation of duties, protect data integrity, implement security protocols, and ensure that scheduled software maintenance and updates are conducted. The policies and procedures will be developed according to the Statewide Information Security Manual and other best practices.

3. INACCURATE FEDERAL REPORTING

The Department of Commerce's Division of Community Assistance submitted Community Development Block Grant (CDBG) reports to the federal agency that were misstated. While testing the federal reports, the following errors and internal control deficiencies were noted:

- The Department did not maintain nor provide complete data to support and ensure the accuracy of the information in the 2012 CDBG Performance and Evaluation Report (PER). The Grants Management System (GMS) is used to record grant expenditures and cash drawdowns which is used to generate the PER Summary. The GMS data did not reconcile to the Department's accounting records and did not agree with the PER report submitted to the federal agency. The total of all expenditures reported was \$9 million overstated compared to the underlying GMS data. Additionally, issues with the data prevented verification of amounts reported by National Objective and federal allocation year within the PER.
- While testing the Section 3 Summary Report, Economic Opportunities for Low – and Very Low-Income Persons, supporting documentation for a sample of 63 subrecipients was reviewed and errors were found for six subrecipients. Each of these six subrecipients had one or more of the following types of errors: lack of documentation to support amounts reported; subrecipients' data not reported; or

AUDIT FINDINGS AND RESPONSES (CONTINUED)

discrepancies between supporting documentation and the amount reported in the Section 3 Summary report. As a result, not all activity was accurately included in the annual report submitted to U.S. Department of Housing and Urban Development (HUD).

- The Department is in noncompliance with reporting requirements under the Federal Funding Accountability and Transparency Act (FFATA). It failed to report, as required, CDBG sub-awards of \$25,000 or more made during fiscal year 2013 in the FFATA Subaward Reporting System. There were 134 subawards that met the criteria for reporting. The Department entered 98 subawards subsequent to year end, but did not complete the submission until December 2013. The other 36 were not entered or submitted.

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

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded April 4, 2012; award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-9-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.

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

The Department should implement procedures to ensure the accuracy of the data in the Grants Management System and ensure it reconciles to the Department's accounting records and federal reporting.

Management Response: DCA will strengthen its internal controls to ensure that reports are prepared in accordance with federal reporting requirements and will implement a grants management system to capture and maintain subrecipient and financial data. DCA will ensure that the data contained in the grants management system is reconciled with Department accounting records and federal reporting.

DCA will implement and maintain a new grants management system to record, manage and produce accurate data regarding grant expenditures and cash drawdowns for the Performance Evaluation Report (PER) and other compliance reporting requirements. DCA will ensure that data contained in the grants management system is reconciled with the Department's accounting data and other systems. The Director, Compliance Section Chief and Business Officer are responsible for implementing this corrective action.

DCA will strengthen its internal controls to ensure that accurate data is collected for and reported in the Section 3 Summary Report. The corrective action will include multiple checkpoints to ensure that subrecipient Annual Performance Report (APR) data are collected and reported accurately.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

DCA will strengthen its internal controls to ensure that all subrecipient awards of \$25,000 and greater are entered into the FSRS (FFATA Sub-Award Reporting System) as required by the Federal Funding Accountability and Transparency Act (FFATA).

4. INACCURATE CASH MANAGEMENT IMPROVEMENT ACT ANALYSIS

Deficiencies were identified in the preparation and review process of the Department of Commerce's Community Development Block Grant Cash Management Improvement Act (CMIA) Analysis. The lack of controls over the CMIA Analysis resulted in failure to report all cash draws and disbursements in the year-end report submitted to the State Controller. The Department's analysis is used by the State Controller to prepare the Statewide CMIA report to the federal government. The weaknesses in the preparation and review processes increase the likelihood that excessive balances may be maintained beyond the federally allowable timeframe or that inadequate funds are drawn down, thereby affecting the computed interest due to or from the U.S. Treasury.

The Department prepares monthly reports of cash draws and disbursements which are then accumulated into the year-end CMIA Analysis report. A test of the year-end report revealed that \$11.4 million of draws and disbursements were omitted as follows:

- \$7.9 million draws and disbursements were omitted from both the monthly and year-end report. This included \$5.5 million in draws and disbursements related to Neighborhood Stabilization Program (NSP), which the Department incorrectly treated as not subject to the Treasury State Agreement.
- \$3.5 million draws and disbursements were included in the monthly reports, but were not transferred to the year-end report.

The failure of the review process to identify errors did not ensure the total draws and disbursements reported reconciled to the program expenditures and draws per the accounting records. This failure increases the risk of noncompliance with federal cash management requirements and the Treasury-State Agreement. Additionally, the failure to properly report impacts the statewide calculation of interest due to or from the U. S. Treasury.

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded April 4, 2012; 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.

Recommendation: The Department should strengthen internal controls to ensure compliance with the Treasury State agreement and that the year-end reports are completed accurately.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Management Response: DCA will strengthen its internal controls to ensure that all cash draws and disbursements are included in the year-end report submitted to the Office of the State Controller. DCA will implement the following procedure. Upon receipt of the CDBG and NSP draw worksheets two verifications of each draw will be performed. Once these verifications have been performed and the information matches that which was submitted by DCA an email is sent to DCA indicating concurrence. If the information does not match, DCA will be notified of any differences and a corrected draw worksheet will be sent by DCA to Fiscal Management with the updated information. When agreement between Cash Management, the Doc. ID Logs, DCA, and Commerce Fiscal has been achieved the CMIA worksheet and the draw worksheet will be sent by email to Office of the State Controller, DCA, and all concerned.

5. INABILITY TO SUPPORT COMPLIANCE WITH EARMARKING REQUIREMENTS

The Department of Commerce's Division of Community Assistance (DCA) did not maintain sufficient documentation to support compliance with federal earmarking requirements for planning and administrative expenditures in the Community Development Block Grant. As a result, there is an increased risk that planning and administrative costs of the State and general local governments (subrecipients) could exceed the 20% allowed under 24 CFR 570.489(a)(3) and not be detected.

Per federal regulations, the total amount expended on planning and administrative costs by the State and local governments combined must not exceed 20%. Detail cost data by type for subrecipients is maintained in the Grants Management System (GMS). However, the total costs from GMS data provided did not reconcile to the Department's accounting records. For fiscal year 2013, expenditures in the accounting records exceeded the GMS costs by \$2.5 million. Additionally, the Department could not provide further evidence to support the actual cumulative amounts of subrecipients' planning and administrative costs.

Based on analysis of the subrecipient data in GMS and State costs from the accounting records, the earmarking requirement has not been exceeded. However, without sufficient documentation to support the accuracy of the subrecipient data, there is no way to be assured that the 20% was not or would not be exceeded if costs have been excluded from GMS.

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded 04/04/2012; award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-9-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.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should strengthen controls to ensure that adequate documentation is maintained to support compliance with federal earmarking requirements.

The Department should ensure that subrecipient costs are accurately tracked and reconciled to the accounting records to ensure earmarking compliance.

Management Response: DCA will maintain a grants management system to record, monitor and produce required reports to ensure that the amount expended on planning and administrative costs does not exceed twenty percent (20%). The data contained in the grants management system will be reconciled with DCA accounting records and other systems.

6. DEFICIENCIES IN SUBRECIPIENT MONITORING

We identified deficiencies in the Department of Commerce's Division of Community Assistance subrecipient monitoring procedures for the Community Development Block Grant (CDBG). As a result, there is an increased risk that noncompliance at the subrecipient level could occur and not be detected or corrected in a timely manner. Subrecipients received approximately \$50 million of Community Development Block Grant funds.

The CDBG program is State administered and local government operated. In accordance with 24 CFR 85.40, the Department is responsible for monitoring the local governments receiving CDBG funds to ensure compliance with federal requirements. Our review of the monitoring efforts identified the following deficiencies described below:

- The Department does not have an adequate monitoring plan to ensure subrecipients are sufficiently monitored throughout the award period for compliance with federal requirements. There was no schedule of when monitoring visits will take place nor was there formal documentation of a subrecipient risk assessment. In accordance with 24 CFR 570.492, the state should perform monitoring, including on-site, as may be necessary and appropriate to ensure subrecipients are in compliance with program requirements. The U.S. Department of Housing and Urban Development – Managing CDBG - A Guidebook for Grantees on Subrecipient Oversight Manual provides guidance for monitoring strategies and procedures. Guidance for monitoring includes the following: monitoring should be an on-going process; a monitoring plan should be developed at the beginning of the program year; a formal risk assessment should be performed to identify which subrecipients require comprehensive monitoring; checklists should be used that specify the particular items or documents to be reviewed in the course of the visit; and checklists should be annotated with notes and identify documentation reviewed to arrive at conclusions.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- We reviewed on-site monitoring files for 29 out of 183 CDBG subrecipients with grant expenditures during the 2013 fiscal year. There were deficiencies noted in the Department's internal policies and procedures and documentation as follows:
 - a. The Grants Management Standard Operating Procedures (SOP) Manual used by the grant representative has not been updated since May 2010. The manual identifies which checklists should be used to perform site visits, however, it does not provide guidance on the documentation that should be reviewed and maintained to support the conclusions on the checklist.
 - b. No guidance was provided in the SOP for what type transactions or documents are to be reviewed during monitoring visits, nor how many items should be reviewed.
 - c. Monitoring checklists contained little or no supporting documentation or notations of the items reviewed to support the work performed and basis for conclusion on subrecipients compliance with a particular requirement.
 - d. There were instances of questions on the compliance checklists being unanswered or partially answered. Specifically, there were 2 instances when the question regarding compliance with allowable costs guidelines, pursuant to OMB Circular A-87, were answered incorrectly as not applicable with no explanation.
- The grant representative performed the close out of one subaward for more than \$190,000 without reviewing the subrecipients final audit report as required by the Department's administrative code, 04 NCAC 19L.913.

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.

In addition to our audit, an investigation was performed by the North Carolina Office of State Budget and Management Office of Internal Audit, at the request of the Department of Commerce, related to a third party CDBG program administrator at 26 local governments. The report was issued February 2014, and contained recommendations for the Department that coincide with the results and recommendations of our audit.

Federal Award Information: This finding affects CFDA 14.228 Community Development Block Grant award B-12-DC-37-0001 awarded April 4, 2012; award B-11-DC-37-0001 awarded January 1, 2011; award B-10-DC-37-0001 awarded January 1, 2010; award B-9-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.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Recommendation: The Department should document a monitoring plan to ensure subrecipients are sufficiently monitored for compliance with federal requirements on an on-going basis.

The Department should enhance procedures and guidelines for monitoring activities to ensure documentation is complete and supportive of the conclusions reached regarding subrecipients compliance.

Department management should implement procedures to ensure that monitoring procedures are well-defined and staff are consistently following procedures when performing subrecipient monitoring visits and in the completion of checklists.

Management Response: DCA will strengthen its internal controls to ensure that the activities of subrecipients 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.

DCA will revise its subrecipient monitoring plan to identify subrecipients that require more comprehensive monitoring based on identified risk. Subrecipients identified as higher risk will receive additional desk and on-site monitoring reviews throughout the life of the grant.

DCA will update its Standard Operating Procedure Manual to include guidance on the types and number of transactions and documents that should be reviewed during monitoring visits and the documentation that should be maintained to support conclusions drawn by monitors and reported on the monitoring checklists.

Monitoring checklists and other documents will be revised where necessary to add supporting documentation and/or notations of the items received to support the basis for conclusions of sub-recipient compliance requirements.

WORKFORCE INVESTMENT ACT OF 1998 (WIA) CLUSTER - CFDA 17.258, 17.259, AND 17.178

7. 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.

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

AUDIT FINDINGS AND RESPONSES (CONTINUED)

out of 23 local area Workforce Development Board 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.

This finding was also reported in the prior year.

Federal Award Information: This finding affects CFDA 17.258 WIA Adult Program, CFDA 17.259 WIA Youth Activities, and CFDA 17.278 WIA Dislocated Workers awards AA-20205-10-55-A-37 for the award period July 1, 2010 - June 30, 2013, AA-21407-11-55-A-37 for the award period July 1, 2011 - June 30, 2014 and AA-22947-12-55-A-37 for the award period July 1, 2012 - June 30, 2015.

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.

Management Response: In November 2013, DWS staff added questions to address this finding to the Oversight Review Guide, the document used to monitor sub-recipient activities funded through the Workforce Investment Act. While the U.S. Department of Labor has not yet issued a final management decision, USDOL staff has indicated that it will accept the changes as submitted.

UNEMPLOYMENT INSURANCE – CFDA 17.225

8. DEFICIENCIES IN PROCESSING AND MONITORING OF OVERPAYMENT INVESTIGATIONS

The Department of Commerce's Division of Employment Security has not been able to investigate and adjudicate potentially inappropriate benefit payments timely; has not maintained adequate records to support investigation findings and has not established overpayments for benefits deemed to be paid improperly. Lack of timely investigation and failure to establish identified overpayments impacts the ability to recover and/or prevent overpayments. Additionally, the lack of adequate documentation impacts the ability to support that the investigation was properly completed and the correct conclusions reached.

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,

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Reporting, and Tracking System (BARTS) and the Inventory Tracking System (ITS) are used to document these potential overpayments and completed case investigations.

A review of the open cases within the Benefit Audit, Reporting and Tracking System as of June 30, 2013 resulted in the following timeliness issues:

- a. Of the 14,060 open and assigned cases, 7,984 (56.8%) had been open greater than a year.
- b. 3,512 of those open and assigned cases had been open for more than two years. The most delinquent case had been open for 1601 days (approximately 4.4 years).
- c. 513 cases have been open for more than one year before being assigned for investigation indicating the potential that cases may remain without action or follow-up for an extended period of time.

The Division of Employment Security records indicated 5,715 benefit integrity investigation cases were closed during state fiscal year 2013. A sample of 60 closed cases identified 29 cases with insufficient documentation to determine that the investigation took place, that the correct determination was reached or that appropriate overpayments were established.

- a. Records for three cases could not be produced. One case had been deleted from BARTS and the case file may have been shredded in violation of the division's records retention policy leaving no record of the investigation, relevant evidence or the basis for the conclusion.
- b. Three cases identified overpayments totaling \$602 that should have been established but no overpayments had been established in the UI Benefits System to facilitate the recovery of the overpayments. These overpayments will be questioned.
- c. Sixteen cases had limited or no supporting documentation. Division practice is to scan all supporting documentation and link it to the BARTS record. These cases had either no linked documents or only blank documents. Documents critical to the investigation such as Wage Audit Notices returned by employers and the listing of wages actually paid were missing.
- d. One case exposed a system override capability where a case originally opened, investigated and closed in 2011 was reopened in fiscal year 2013. The case open date in BARTS was changed from 2011 to 2013, leading to the appearance that the case had been opened and closed on the same day during the audit period. The ability to override the original open date provides the opportunity for investigators and managers to change 'overdue' cases to 'current' and affect the metrics used by management to assess job performance and federal reporting data.
- e. Five cases did not contain the necessary documentation to support the decision to or not to establish an overpayment. Two cases had overpayments established in the

AUDIT FINDINGS AND RESPONSES (CONTINUED)

UI Benefit System for the same weeks investigated in the case, but no overpayment was noted in the case or BARTS. The three other cases contained documentation to suggest an overpayment should have been established but was not.

- f. One case had been opened in 2011 and determined to be overpaid. However, due to a BARTS printing problem the overpayment notice was not sent. The case was set aside for two years and finally resolved in 2013.

Additionally, within the sample of 60 closed cases, six cases had been open and assigned for more than one year before being closed. Cases that remain open for an extended period of time can allow benefits to continue after the potential for fraud has been identified and the total overpayment to be larger than if prompt action had been taken.

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. Additionally, the Division's record retention and disposition policy requires that records subject to audit or legally required for ongoing official proceedings must be retained until released from such audits or official proceedings. These investigation files are subject to audit and are used as evidence in claimant appeals and legal proceeding for suspected fraud.

Aspects of this finding were reported in the prior year.

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 Division should improve review of case log reports to ensure cases are handled in a reasonable time period which should be established in policy. Additionally, management should implement procedures to address the current and prevent future case backlogs.

The Division should enhance policies outlining the procedures investigators should use in investigating and documenting cases, which should include supervisory review to ensure documentation is sufficient and supports the resolution.

The Division should adhere to Division and State record retention policies.

Finally, the Division should investigate the underlying causes for the deficiencies noted and implement procedures to address.

Management Response: For fiscal year ending 2013, DES identified more than 16,000 cases within the backlog as reported from the BARTS application that required investigation and/or review for potential inappropriate benefit payments. Using the corrective action methods as communicated for fiscal year ending 2012, DES was able to reduce the backlog by more than 2,000 within fiscal year 2013. Although DES showed improvement in 2013, DES recognizes the need to use more automation to more quickly

AUDIT FINDINGS AND RESPONSES (CONTINUED)

and more accurately address the backlog. Therefore, DES is currently working with Onpoint Technology to fully maximize and utilize the BARTS application and hope to significantly reduce the backlog to no more than 5000 cases by fiscal year ending 2014. In addition to working with the vendor to improve the use of BARTS, DES has made some organizational changes to improve the supervision of the unit charged with investigating those that may be receiving unemployment benefits while potentially having active employment.

9. INACCURATE FEDERAL REPORTING

Deficiencies were identified in the preparation and review process for the quarterly ETA 227 – *Overpayment Detection and Recovery Activities* reports which resulted in misreporting the change in overpayment receivables by \$10 million and inaccuracies in the reported number of overpayments established.

The Department of Commerce's Division of Employment Security prepares the ETA 227 report using reports from the UI Benefit system, spreadsheets and manual paper notepad calculations. The transfer of data between manual calculations and spreadsheets increases the risk of keying errors and miscalculations.

The December 2012 and June 2013 quarterly ETA 227 reports were tested and the following errors were noted:

- One line on the December report was left blank due to a failure to transfer the data from the supporting documentation. This resulted in nine cases not being counted.
- On the June report, a \$10 million keying error in the calculation of the change in overpayment receivable resulted in reporting an increase of \$9,759,594 in the receivable balance, when it should have been a \$240,406 decrease. The mistake was due to a manual notepad calculation error.
- Based on the Unemployment Insurance Reports Handbook No. 401 line by line instructions for the ETA 227, 243 tips and leads type cases were added to the wrong line on the December report, while 668 of the same type counts were excluded from the June report. No overpayment dollars were added in relation to these cases. The Division could not provide evidence that these dollars were or were not already included in the report nor could they explain how dollars, and not case counts, would be captured in the system report use to develop the data. Therefore, it is unclear if the December report is overstated or the June report is understated.

Based on errors noted, the review process was not sufficient to prevent significant errors and increases the risk that federal reporting will be incomplete, inaccurate and noncompliant.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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 Division should improve controls over the ETA 227 federal report to ensure it is prepared in accordance with federal reporting guidelines and sufficiently reviewed for completeness and accuracy.

Management Response: DES will develop extract files from the Guide application to assist the Benefits Integrity unit in creating the ETA 227 report. These extract files will be made available to the LEAD unit for comparison and review. These extracts will feed into spreadsheets that will calculate both dollars and counts for the ETA 227, thus eliminating human error. This will also reduce the need to tally both counts and dollars manually on notepads, thus allowing for more accurate reporting of the ETA 227. In addition to these changes, the LEAD unit will be required to double check the ETA 227 report entries with Benefits Integrity management before submission to the United States Department of Labor. LEAD and Benefit Integrity management's review will be evidence by appropriate personnel signing off on the report certifying that the report is complete and accurate. Future inaccurate submissions of the ETA 227 report will be reflected in the performance management documents of personnel responsible.

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