

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR
BETH A. WOOD, CPA



DEPARTMENT OF COMMERCE

RALEIGH, NORTH CAROLINA

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES
FOR THE YEAR ENDED JUNE 30, 2014



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STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
John E. Skvarla, III, 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, 2014. 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 was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

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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State Auditor

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Article V, Chapter 147 of the North Carolina General Statutes, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

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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**

John E. Skvarla, III, Secretary
and Management of the Department of Commerce

Report on Compliance for Each Major Federal Program

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, 2014, 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 (WIA) Cluster
 - CFDA 17.258 – WIA Adult Program
 - CFDA 17.259 – WIA Youth Activities
 - CFDA 17.278 – WIA Dislocated Worker Formula Grant
- Employment Services Cluster
 - CFDA 17.207 – Employment Service/Wagner-Peyser Funded Activities
 - CFDA 17.801 – Disabled Veterans' Outreach Program
 - CFDA 17.804 – Local Veterans' Employment Representative Program
- 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 14.225 – Community Development Block Grants/Sate's Program and Non-Entitlement Grants in Hawaii – (Recovery Act Funded)

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 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 and 4 in the Findings, Recommendations, and Responses section of this report.

Report on Internal Control Over Compliance

Management of Department of Commerce 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 3 and 4 in the Findings, Recommendations, and Responses section of this report to be material weaknesses in internal control over compliance. Furthermore, we consider the deficiencies described in findings 1 and 2 in the Findings, Recommendations, and Responses section of this report to be significant deficiencies in internal control over compliance.

Department of Commerce's Responses to Audit Findings

The Department's responses to the findings identified in our audit are included in the Findings, Recommendations, and Responses section of this report. The Department's 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.

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.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 24, 2015



FINDINGS, RECOMMENDATIONS, AND RESPONSES

MATTERS RELATED TO FEDERAL COMPLIANCE OBJECTIVES

UNEMPLOYMENT INSURANCE

1. Documentation to Support Benefit Overpayment Investigations Was Not Maintained

The Department of Commerce's Division of Employment Security did not maintain adequate documentation to support the decisions for some of the cases investigated for overpayment of unemployment claims. During the audit period, the Department investigated and closed 61,005 cases. From those investigations, the Department determined that overpayments of approximately \$50 million were made in 54,527 cases and no overpayments were made in 6,478 cases.

In a sample of 100 case files representing closed investigations, 24 case files did not have the required documentation to support the investigation conclusion. Specifically, we noted the following:

- For 22 investigations, the original Wage Audit Notice could not be located to support the wage data recorded in the Benefit Audit Reporting and Tracking System (BARTS).
- For one investigation, no documentation was available because the Department had purged the documentation from the system and shredded any physical files that had been used in the investigation. The case was closed between October and December 2013 and documentation should not have been purged per Department policy. The Department could not provide an explanation for purging the files. Because overpayment collections are performed outside of the Benefit Integrity investigation section and an overpayment had been collected, it was evident that an investigation occurred. However, without documentation, auditors were unable to determine the appropriate overpayment was identified for collection.
- For one investigation, no wage data had been recorded in BARTS and the original Wage Audit Notices could not be located.

As a result, documentation in some cases could not be located to verify that the investigation was adequate and that the correct determination was reached. Additionally, the lack of documentation could impact the Department's ability to defend against a claimants appeal and collect the overpayment.

The Benefit Integrity section, which is responsible for overpayment investigations, had staffing changes and a breakdown in management oversight that caused the corrective action plan from a similar prior year finding not to be fully implemented.

The Division's internal procedures require that investigation case files include a Wage Audit Notice, which documents the earnings of the individual being investigated and is used to help determine if overpayments were made and the amount of the overpayment.

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

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

Federal Award Information

This finding affects CFDA 17.225 Unemployment Insurance funding from the State and Federal Unemployment Trust Funds.

Recommendations

The Division should have procedures in place to ensure adherence to Division and State record retention policies and to ensure that adequate documentation is maintained to support the cases investigated for overpayment.

The Division should implement procedures to ensure that documentation is sufficient and maintained to support the investigation results

Agency Response

The Department of Commerce, Division of Employment Security (DES) is working to develop a tracking/reporting process that can be placed on the DES internal network, which will make review by internal and external auditors more accessible. Additionally, the use of new technologies, such as, Right Fax and Adobe Professional will allow UI Benefits Integrity staff to digitize case information. This will allow investigators to upload documents into the electronic folders created on the shared network, thus making cases easier to locate and more searchable.

Anticipated Completion Date: 06/30/2015

WORKFORCE INVESTMENT ACT CLUSTER

2. Procedures Not Established to Track and Verify the Receipt of Subrecipient Site-Visit Action Plan

The Department of Commerce's Division of Workforce Solutions did not have procedures to verify the receipt of subrecipients' corrective action plans that ensure subrecipients are taking steps to address deficiencies identified during on-site monitoring visits. There were 23 subrecipients that received \$69 million in Workforce Investment Act Cluster (WIAC) funds during the audit period.

Eleven subrecipients, receiving approximately \$32 million in WIAC funds, failed to submit a written corrective action plan by the required date and no additional follow-up procedures were performed by the Division to obtain the action plan.

As a result, noncompliance and/or other procedural issues could go uncorrected at the subrecipient level. Examples of site visit deficiencies include:

- Incomplete or missing documentation in program recipient eligibility files

- Errors in participant data maintained in the statewide participant database
- Outdated, missing or incomplete policies and procedures
- Improper makeup of workforce development board membership

The Division has a site-visit schedule that includes the dates for the visits and issuance of the subrecipient's summary report. However, the Division failed to include the tracking of when corrective action plans are due, received and reviewed to ensure subrecipients have a plan for timely action to address deficiencies identified during site-visits.

The Department must conduct an annual on-site monitoring visit to ensure each subrecipients' compliance with the U. S. Department of Labor's uniform administration requirements as required by Workforce Investment Act Section 184(a)(4). At the conclusion of the on-site monitoring visit each subrecipient receives an Oversight Summary Report which informs them of the results of the site-visit and requires them to respond to any findings with a written plan of action within a standard of 14 business days.

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-21407-11-55-A-37 for the period of April 1, 2010 – June 30, 2014; AA-22947-12-55-A-37 for the award period of April 1, 2012 – June 30, 2015 and AA-24104-13-55-A-37 for the award period of April 1, 2013 – June 30, 2016.

Recommendations

The Department should implement procedures to ensure the receipt of the subrecipients' corrective action plans regarding issues identified during the on-site monitoring visit.

The Department should follow-up when corrective action plans are not received to ensure that subrecipients have a plan for timely corrective action.

Agency Response

Division staff use a tracking form that contains information on site visits to all sub-recipients. This form also includes a column for the due date of the response to any findings or recommendations, as well as, a column for the date the response was received. While staff do follow-up on late responses, usually by phone or e-mail, that follow-up information is not always documented in the monitoring file.

Staff will continue to use the tracking form to monitor response due dates and will be more conscientious about documenting in the monitoring file any follow-up on late monitoring responses from the sub-recipients during the monitoring cycle for Program Year 2014.

Anticipated Completion Date: March 9, 2015

3. Subaward Obligations Were Not Reported Timely and Contained Errors

The Department of Commerce's Division of Workforce Solutions did not report Workforce Investment Act Cluster subaward obligations exceeding \$25,000 within the time period established by the Federal Funding Accountability and Transparency Act (FFATA). In addition, one subaward obligation was reported multiple times in the FFATA Subaward Reporting System (FSRS).

The Division filed 12 FFATA reports that contained 68 subawards totaling \$52.8 million during the audit period. Nine of the 12 reports were filed late, of which 6 were filed between one and four months late. This resulted in 57 subawards totaling \$52 million being reported after the required date.

In addition, a subaward for \$200,000, awarded in June 2013 was initially reported in the September 2013 FFATA report, which was two months late. The same subaward was included in the reporting for the months of July, October, and December 2013, all of which were submitted in January 2014. In the FSRS, the duplicative reporting gives the appearance that the subrecipient received \$3,000,000 in subawards when it only received \$2.4 million.

As a result, the federal awarding agency and the public did not have timely and accurate notification of subawards issued by the Department. The Federal Funding Accountability and Transparency Act was enacted to show citizens how federal funds are spent in their communities.

The subawards were not reported timely due to the Division management placing a low priority on filing the reports. Additionally, reports were not being reviewed before submission to ensure accuracy of subawards reported.

The Federal Funding Accountability and Transparency Act requires states to report any subawards issued for more than \$25,000 in the federal reporting system by the end of the month following the month the subaward is issued.

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-22947-12-55-A-37 for the award period of April 1, 2012 – June 30, 2015 and AA-24104-13-55-A-37 for the award period of April 1, 2013 – June 30, 2016.

Recommendations

The Department should have procedures in place to ensure that FFATA reports are prepared accurately and submitted timely.

The Department should consider staffing resources to meet federal reporting requirements.

Agency Response

Finance staffing has been hired to bring unit to full staff. Current year reporting has been submitted timely and accurately. Monthly review for updates of equal or greater than \$25,000 per subrecipient has been initiated into controls to maintain accuracy.

Anticipated Completion Date: March 9, 2015

COMMUNITY DEVELOPMENT BLOCK GRANT (CDBG) – STATE-ADMINISTERED SMALL CITIES PROGRAM CLUSTER

4. Subaward Obligations Were Not Reported Timely

The Department of Commerce's Rural Development Division did not report Community Development Block Grant subaward obligations exceeding \$25,000 within the time period established by the Federal Funding Accountability and Transparency Act (FFATA).

The Division made 24 subaward obligations totaling \$14.2 million during the audit period. Nine subawards totaling \$4.8 million were reported in the FFATA Subaward Reporting System (FSRS) between one and four months after the required date.

As a result, the federal awarding agency and the public did not have timely notification of subawards issued by the Department. The Federal Funding Accountability and Transparency Act was enacted to show citizens how federal funds are spent in their communities.

The Division had entered the nine subawards, but did not complete the submission process in the federal reporting system until December 2013 and January 2014 which resulted in the subawards being reported after the required due date.

The Federal Funding Accountability and Transparency Act requires states to report any subawards issued for more than \$25,000 in the federal reporting system by the end of the month following the month the subaward is issued.

Federal Award Information

This finding affects CFDA 14.228 Community Development Block Grant awards B-13-DC-37-0001 awarded July 30, 2013 and B-12-DC-37-0001 awarded April 4, 2012.

Recommendation

The Division should have procedures in place to ensure that subaward obligations are reported timely.

Agency Response

The Finance Section of the State CDBG program is tasked with data entry for the FFATA compliance requirement. For all future awards, staff will insure that FFATA records are entered in a timely manner and will record the date entered into the FSRS system thereby creating a record of compliance.

Anticipated Completion Date: March 12, 2015

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This audit was conducted in 4,262 hours at an approximate cost of \$400,675.