



# STATE OF NORTH CAROLINA

**DEPARTMENT OF PUBLIC INSTRUCTION**

**FISCAL CONTROL AUDIT**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**DEPARTMENT OF PUBLIC INSTRUCTION**

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## AUDITOR'S TRANSMITTAL

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September 26, 2011

The Honorable Beverly Eaves Perdue, Governor  
The General Assembly of North Carolina  
State Board of Education  
The Honorable Dr. June St. Clair Atkinson, State Superintendent  
Department of Public Instruction

This report presents the results of our fiscal control audit at the Department of Public Instruction. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed a deficiency in internal control that is considered reportable under *Government Auditing Standards*. The item is described in the Audit Findings and Responses section of this 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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# **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS**

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## **OBJECTIVES, SCOPE, AND METHODOLOGY**

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the Department of Public Instruction. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of state agencies and institutions.

The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

To accomplish our audit objectives, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions

## **OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)**

based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit scope covered the period July 1, 2010 through January 31, 2011 and included selected internal control over the following accounts and control objectives:

*Contracted Personal Services* – These are expenditures incurred for services purchased from independent contractors and/or external organizations for contracted professional and consultative personal services. These services are needed for maintenance and/or ongoing operations and cannot be provided by the current staff. Our audit was limited to the Academic Services and Miscellaneous Contractual Services subcategories, which accounted for approximately \$90 million during the audit period. Academic Services include expenditures for services purchased through contracts with educational institutions. Miscellaneous contractual services include expenditures incurred for contractual services not classified elsewhere, such as the costs of personal service agreements for consulting services performed by independent contractors. We examined internal control designed to ensure that the Department properly accounted for the expenditures and that purchases were made in compliance with state purchase and contract regulations.

*Workers' Compensation and Administrative Services* – Workers' compensation includes payments made under the Workers' Compensation Program to employees who suffer job related injuries and illnesses. These payments cover medical, surgical, hospital, nursing rehabilitation services, medicines, medical travel, and medical supplies. During the audit period, the Department reported approximately \$25.7 million in medical payments. Workers' Compensation payments are processed through an external administrator for both the Department and local educational agencies. Administrative Services include the cost of services provided by an external administrator to manage workers' compensation claims. On January 31, 2011, the Department reported total administrative payments of approximately \$733,000 made to an external administrator for managing the Workers' Compensation Program. We examined internal control designed to ensure that the workers' compensation and administrative payments were reasonable and made in compliance with State statutes, rules and regulations, and contractual requirements.

### **RESULTS**

The results of our audit disclosed a deficiency in internal control that is considered reportable under generally accepted government auditing standards. The deficiency is described in the Audit Findings and Responses section of this report.

## AUDIT FINDINGS AND RESPONSES

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### WORKERS' COMPENSATION PAYMENT REVIEW PROCESS NEEDS IMPROVEMENT

The Department did not adequately review the supporting documentation for workers' compensation claims. As a result, there is an increased risk that the Department could make erroneous payments. The Department paid approximately \$25.7 million in workers' compensation claims during the audit period.

The Department contracts with an outside organization to administer the workers' compensation program. This organization's administrative duties include approval of valid claims and determination of claim amounts. Periodically, the organization sends a billing summary and a check register to the Department. Before payments are made the Department compares the total amount on the billing summary to the total amount on the detailed check register. This review ensures that the total amount requested agrees with the claims to be paid, but does not provide assurance that the individual payments are for correct amounts and eligible claims.

Effective controls require procedures to ensure outsourced duties are properly performed.

*Recommendation:* The Department should enhance its review process to ensure workers' compensation claims are adequately reviewed before claims are paid.

*Agency Response:* The Department agrees that the review should be enhanced and is adding controls to visually scan the payment register received from the third party administrator and to research further any large, unusual payments, payments that do not contain the DPI code, or payments to unidentifiable NC local education agencies.

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## **ORDERING INFORMATION**

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