



STATE OF NORTH CAROLINA

DEPARTMENT OF COMMERCE – FISCAL MANAGEMENT DIVISION
FINANCIAL RELATED AUDIT
STATE GRANT FUNDS MONITORING

NOVEMBER 2012

OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

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AUDITOR'S TRANSMITTAL

November 15, 2012

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
Mr. J. Keith Crisco, Secretary, Department of Commerce

This report presents the results of our financial related audit at the Department of Commerce, Fiscal Management Division. 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 results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses section of this report.

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Beth A. Wood, CPA
State Auditor

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BACKGROUND AND GENERAL OBJECTIVES

BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Department of Commerce, Fiscal Management Division (Division). The audit was performed as part of our effort to periodically examine North Carolina's process for managing grants and to report on the financial practices of state agencies and institutions.

The Department of Commerce's Fiscal Management Division (Division) is responsible for administering non-competitive state grant funds awarded by the General Assembly to local governments and non profits. Specifically, the Division is responsible for:

- Drafting the grant contracts in accordance with the terms the General Assembly specified in statute;
- Disbursing the funds to grantees according to the direction of the General Assembly;
- Monitoring grantee performance of the grant program, and;
- Monitoring grantee spending of state grant funds.

The Division is required to monitor grant recipients, except grantees subject to the Local Government Commission, in compliance with *North Carolina General Statute 143C-6-23* and the North Carolina Administrative Code Title 9, SubChapter 03M. Additionally, the Division developed a written monitoring plan with documented procedures to provide guidance for effective grant recipient monitoring.

GENERAL OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. The specific fiscal matters included in the audit are described in the Scope and Specific Objectives section of this report.

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. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

SCOPE AND SPECIFIC OBJECTIVES

Our audit scope covered the period July 1, 2010, to June 30, 2011 and included selected internal controls over state funded grant monitoring practices. Specifically, we evaluated the Division's grant monitoring plan against state requirements and best practices and tested the Division's compliance with its plan in monitoring the specific grants the Division administers. The Department administers other state grants throughout its various divisions. However, these other grants were not included in the scope of our audit. The scope period included information on grants from fiscal year 2010 and fiscal year 2011.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the Scope and Specific Objectives section of this report 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 provide evidence about our audit objectives. Specifically, we performed procedures such as interviewing personnel, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions. Whenever sampling was used, we applied a non-statistical approach. As a result, we were not able to project our results to the population.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, 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 audit in accordance with generally accepted government auditing standards applicable to performance audits. 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 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.

RESULTS AND CONCLUSIONS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report. Management's responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them.

AUDIT FINDINGS AND RESPONSES

1. INADEQUATE GRANT RECIPIENT MONITORING

The Department of Commerce Fiscal Management Division (Division) did not adequately apply grant monitoring procedures to ensure that grantees were meeting grant objectives and that grant expenditures were reasonable. As a result, there is an increased risk that approximately \$80 million in state funds disbursed in fiscal year 2011 were not being used for their intended purpose.

Lack of Grantee Risk Assessments

The Division's monitoring plan calls for a continuous risk assessment approach. But the Division did not follow its own policy to continuously identify, evaluate, and manage risks that may impact a grantee's ability to meet the goals and objectives set by state grant awards. Without continuous risk assessments, the Division was unable to determine the proper level of monitoring required for each grantee receiving state funds and consequently did not conduct on-site monitoring visits.

Prior to the initiation of our audit, the Division performed risk assessments for only five (25%) of the 20 grantees receiving state funds during the 2011 fiscal year. Four of those risk assessments were performed as early as 2009 and therefore may not accurately reflect a grantee's current risk profile. In other words, the Division did not determine the proper level of monitoring for 15 grantees (75%), and assessments for most of the remaining grantees (20%) were not current.

Since that time, the Division brought in a temporary resource to assist in completing risk assessments for grantees that received state funds in fiscal years 2011 and 2010. As of June 30, 2012, risk assessments have been completed for:

- 11 (55%) grantees receiving state funds in fiscal year 2011;
- 14 (70%) grantees that received state funds in fiscal year 2010.

Federal guidance identifies risk assessments as tools for developing effective monitoring plans. The Office of Management and Budget states that management should identify risks that could prevent agencies from meeting its goals and objectives and analyze those risks for their potential effect or impact on the agency.¹ The Office of the Inspector General suggests that granting agencies have an effective risk assessment model in order to provide proper monitoring of grantees.²

A continuous risk assessment helps identify specific processes or systems at the grantee level that threaten the grantee's ability to meet grant program goals and objectives. The monitoring plan states that, "Continuous monitoring is the core of effective assurance

¹ Executive Office of the President, Office of Management and Budget, "OMB Circular A-123, Management's Responsibility for Internal Control." Page 7. Revised December 21, 2004.

² United States Department of Justice, Office of the Inspector General "Improving the Grant Management Process." Page 4. February 2009

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strategies...in maintaining a higher level of assurance that controls are working, risks are being managed, and the information used for decision-making has integrity.”³

Because the Division did not continuously identify and evaluate grantee risks, it was not able to determine the appropriate level of monitoring for grantees. As a result, there is an increased risk that approximately \$80 million in state funds were not properly monitored and less assurance that grant funds were used for their intended purpose.

Lack of Grant Performance Evaluations

The Division did not evaluate whether grantees have achieved the objectives or outcomes outlined in their grant agreements because it contends that this function is performed by the General Assembly. However, the North Carolina Administrative Code requires each grant awarding agency to perform this function by evaluating actual grantee accomplishments.⁴

As of May 2012, the Division had not completed grant performance evaluations for:

- 17 (100%) of 17 2011 grantees to determine if goals and objectives had been met;
- 16 (94%) of 17 2010 grantees to determine if grant goals and objectives had been met.

Since that time, the Division brought in a temporary employee to assist in completing grant performance evaluations for grantees that received state funds in fiscal years 2011 and 2010. As of June 30, 2012, grant performance evaluations had been completed for:

- Four (24%) of 17 grantees that received state funds in fiscal year 2011;
- 11 (65%) of 17 grantees that received state funds in fiscal year 2010.

Grantees receiving \$25,000 or more within its fiscal year are required to submit to the grantor agency, six months after the end of the grantee’s fiscal year, a description of activities and accomplishments undertaken by the grantee with the state funds.⁵ Grantors are required to conduct periodic monitoring reviews to determine that performance goals are achieved.⁶ Without periodic evaluations completed by the Division, there is a risk that non-performing grantees will continue to receive state funding.

Lack of On-site Monitoring Visits

The Division did not conduct any on-site visits to verify whether proper internal control procedures are being followed and or to verify information provided by the grantee. There was no documentation on file that on-site visits were conducted during fiscal years 2010 or 2011. In fact, the Division stated that no site visits were completed for continuous grantees since 2009.

³ Department of Commerce Fiscal Management Division Monitoring Plan – MP-005 Overview of Monitoring Procedures and Tools. Revised September 1, 2007.

⁴ 09 NCAC 03M .0704(a) Grant Monitoring and Evaluation

⁵ 09 NCAC 03M.0205 Reporting Thresholds and Formats for Grantees and Subgrantees

⁶ 09 NCAC 03M.0401(10) Agency Responsibilities, and 09 NCAC 03M .0704 Grant Monitoring and Evaluation

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Federal guidance states that granting agencies should conduct more site visits to grantees to ensure that information reported by the grantee is accurate, complete, and aligns with grant goals.⁷ Both the NC Administrative Code⁸ and the Division's Monitoring Plan⁹ state that periodic site visits may be performed to monitor grantee performance and compliance with laws, rules, and grant terms.

The Division indicated it did not conduct grantee site visits because it lacked the general resources (money, staff, and time) to do so. According to Division policies, site visits occur after a grantee is determined to be at a high risk of not meeting grant objectives or administering state funds in compliance with laws, rules and grant contract terms. However, as noted earlier, the Division did not complete risk assessments for 75% of its grantees in Fiscal Year 2011.

Without conducting periodic site visits to grantee locations, the Division is not able to verify if grantee internal control procedures are being followed as intended. As a result, the Division is not able to provide assurance that grantees administered approximately \$80 million in state funds in compliance with laws, rules, and the provisions of grant contracts.

Lack of Sub-recipient Monitoring

The Division did not evaluate the monitoring procedures and activities of grantees that award state grant funds to other organizations (sub-recipients). The Division stated it did not request documentation of grantee sub-recipient monitoring procedures because the NC Administrative Code does not specifically require it.

However, without reviewing grantee sub-recipient monitoring policies and procedures, the Division has no knowledge of how approximately \$18 million in state funds passed down in 2011 are spent. As a result, the Division has no assurance that sub-recipients are held accountable for the legal and proper spending of state grant funds.

The Division did not obtain and review grantee monitoring policies, procedures, or any other documentation that would provide a reasonable assurance that the grantee is adequately monitoring sub-recipients of state funds.

Both North Carolina General Statute¹⁰ and Administrative Code¹¹ require state agencies to hold grantees and sub-grantees accountable for how they spend state grant funds. Additionally, the Division's Monitoring Plan states that its responsibility is "to gain a

⁷ United States Department of Justice, Office of the Inspector General "Improving the Grant Management Process." Page 4. February 2009

⁸ 09 NCAC 03M .0704 Grant Monitoring and Evaluation

⁹ Department of Commerce Fiscal Management Division Monitoring Plan – MP-006 Risk Assessment Policy. Revised September 1, 2009.

¹⁰ NCGS 143C-6-23(d)(4)

¹¹ 09 NCAC 03M .0401(6)(b)

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reasonable assurance that the grantee that received a state legislative award is adequately performing that [sub-grantee monitoring] function.”¹²

The importance of monitoring sub-recipients is further emphasized by the Inspector General of the US Environmental Protection Agency. In a report dated October 2005, the agency noted that many sub-recipients are small organizations that often lack experience and training in grants management. The report states that it is important that grantees “identify, prioritize, and manage potential at-risk sub-recipients to ensure that grant goals are reached and resources properly used.”¹³

Recommendation:

The Division should establish and enforce timelines to ensure risk assessments and grant performance evaluations are completed in a timely manner.

The Division should perform risk assessments for each grantee before state grant funds are disbursed, as well as on-going risk assessments throughout the grant program period.

The Division should develop an appropriate site visit schedule based on grantee risk assessments. Site-visits should verify that state funds are being spent in accordance with the grant objective and provisions.

The Division should require all grantees to submit sub-recipient monitoring policies and procedures and should evaluate them for adequacy.

Agency Response:

The General Assembly provides state aid as pass through funding to designated entities in designated amounts in the annual state appropriation act without input from the Department. This pass through funding to designated entities is provided to non-profit corporations with governing board of directors or local governments with elected leadership.

The General Assembly receives Legislative Annual Reports to ensure each Grantee is using the funds awarded according to their authorized purpose. Each recipient of state aid is required by law to complete and submit an Annual Report to the General Assembly each year that includes program activities, objectives and accomplishments, itemized expenditures and funding sources, in addition to, audited financial statements.¹⁴ The Division has revised its internal policies to implement a 120 day deadline after its receipt to complete the grant performance evaluations as part of the annual desk review process.

¹² Department of Commerce Fiscal Management Division Monitoring Plan – MP-008 Monitoring Subgrantees. Revised September 1, 2009.

¹³ Domestic Working Group Grant Accountability Project. “Guide to Opportunities for Improving Grant Accountability.” October 2005.

¹⁴ Auditor’s note – Other than the financial statements, none of the other information submitted to the General Assembly is audited or verified by auditors or other independent sources.

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Per the recommendation of the State Auditor's Office, the Division has revised its internal Risk Assessment policy to complete risk assessments prior to the disbursements of funds based on each recipients' prior year performance. As part of on-going risk assessments, at such time as the Division becomes aware of a change in a recipient organization's business practices, leadership or status an updated risk assessment will be conducted.

The Division will perform at least 2 on-site visits each fiscal year to recipients based on the result of risk assessments. Higher risk recipients will be a priority when scheduling visits.

The Division revised the sub-recipient section within each state aid contract for FY 2012-13 to require each recipient to provide the Division a copy of their organization's internal sub-recipient monitoring policy. The Division will evaluate policies for adequacy.

2. INADEQUATE REVIEW OF GRANTEE REPORTS

The Division did not adequately review information submitted by grantees that shows how state grant funds are spent. Specifically, the Division did not verify grantee expenditures by reviewing supporting documentation. Additionally, the Division did not review reports submitted by grantees in a timely manner. As a result, grantees were not held accountable for how approximately \$80 million in state grant funds were spent during fiscal year 2011.

Grantee Expenditures Not Verified

The Division policies require that a random sample of quarterly expenditure reports by grantees be verified by reviewing supporting documentation from the grantee. But this policy is not followed by the Division.

The Division was only able to verify \$100,000 (.125%) of the approximate \$80 million in state funds awarded to grantees in 2011. Only one (5%) of 20 grantees submitted documentation to support the amount reported as expended state funds. In this case, the grantee voluntarily submitted copies of invoices that were paid with state grant funds.

Conversely, 19 (95%) of the 20 grantees did not submit supporting documentation for state grant expenditures. The Division did not request nor require any such documentation from these grantees.

The National State Auditors Association states that, as part of an effective monitoring process, agencies are expected to:

- Review and verify the data submitted for accuracy and reliability;
- Document the verification of work done and its results;

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- Take additional steps to acquire information useful to management and policy-makers that is not included in the data previously collected.¹⁵

Since it did not verify grantee expenditures by reviewing supporting documentation, the Division is not able to hold grantees accountable for how they spent state funds. As a result, there is a risk that approximately \$80 million in state grant funds disbursed in fiscal year 2011 were not spent as authorized by the General Assembly.

Grantee Reports Not Reviewed Timely

The Division did not perform timely reviews of reports submitted by grantees. Quarterly and annual reviews were not done timely because the Division has not established deadlines for their completion. Additionally, there is no supervisory review or monitoring of the review process to ensure it is completed in a timely manner.

As of June 30, 2012:

- 13 (76%) of 17 grantees had not received annual reviews for 2011;
- 6 (35%) of 17 grantees had not received annual reviews for 2010.

Even the 11 desk reviews the Division did perform for fiscal year 2010 were not done timely. On average, those reviews were conducted more than a year after the reports were received.

The Division did not document the date quarterly reports were reviewed. Therefore, auditors were not able to determine when these reviews were completed. However, the Division stated that multiple quarters were often reviewed at once, suggesting that some reviews were not completed timely.

The Office of Management and Budget (OMB) states communication and information should exchange in a form and time frame that allow people to carry out their assigned responsibilities. The OMB also states that reporting should be provided timely for review and appropriate action.¹⁶

Without continuous monitoring and timely reviews, the Division is not able to ensure that grant objectives are attained and grant expenditures are reasonable. Additionally, the Division is not able to determine if grantees are complying with all applicable laws, regulations, and contract terms.

Recommendation:

The Division should obtain and verify documentation to support grant expenditures. The Division should assess the documentation for accuracy and reliability.

¹⁵ National State Auditors Association, "Best Practices in Carrying out State Economic Development Efforts." Page 5. © 2004.

¹⁶ Executive Office of the President, Office of Management and Budget, "OMB Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations." Page 6-3. Revised June 2012.

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The Division should establish and enforce deadlines for completing quarterly and annual report reviews.

Agency Response:

The Division has completed reviews of FY 2010-11 Quarterly Reports and initiated desk reviews of the FY 2010-11 Annual Compliance Reports submitted on 3/31/12. Additionally, the Division has requested and received and is currently reviewing FY 2011-12 supporting documentation from four state aid recipient organizations.

The Division has revised its internal policies to implement a 120 day deadline after its receipt to complete its' review of the state aid recipients' semi-annual quarterly reports and NC Grants Annual Compliance Reports.

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This audit required 1,443 audit hours at an approximate cost of \$103,896. The cost represents .13% of the \$80 million in total expenditures subjected to audit.