



STATE OF NORTH CAROLINA

DEPARTMENT OF PUBLIC INSTRUCTION

**RESULTS OF AUDIT PROCEDURES APPLIED TO THE
DESIGN OF INTERNAL CONTROL OVER COMPLIANCE
FOR SELECTED PROGRAMS AWARDED
AMERICAN RECOVERY AND REINVESTMENT ACT FUNDS**

FOR THE YEARS ENDED JUNE 30, 2009 AND JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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April 16, 2010

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

This communication is provided pursuant to the *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement*, which encourages auditors to communicate, at an interim date, control deficiencies related to federal programs with American Recovery and Reinvestment Act of 2009 (ARRA) funding that are, or likely to be, significant deficiencies or material weaknesses in internal control over compliance. Accordingly, this communication is based on our assessment of the design of internal control over compliance. Because we have not completed our compliance audit, additional significant deficiencies and material weaknesses may be identified and communicated in our final report on compliance and internal control over compliance issued to meet the reporting requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

As part of our audit of the State of North Carolina's compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that are applicable to its major federal programs for the years ending June 30, 2009 and June 30, 2010, we are considering the State's internal control over compliance with these requirements that could have a direct and material effect on the major programs in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 the State of North Carolina's internal control over compliance.

We performed these audit procedures at the Department of Public Instruction on the following programs that have received American Recovery and Reinvestment Act funds:

- CFDA 84.389: Title I Grants to Local Educational Agencies Recovery Act – In April 2009, the Department was awarded approximately \$128.7 million in ARRA funds under this program. As of November 3, 2009, the Department had received and expended approximately \$26.9 million of this ARRA grant.
- CFDA 84.391: Special Education – Grants to States Recovery Act – In April 2009, the Department was awarded approximately \$157.2 million in ARRA funds under this program. As of November 3, 2009, the Department had received and expended approximately \$49.8 million of this ARRA grant.
- CFDA 84.392: Special Education – Preschool Recovery Act– In April 2009, the Department was awarded approximately \$6 million in ARRA funds under this program. As of November 3, 2009, the Department had received and expended approximately \$1.6 million of this ARRA grant.

- CFDA 84.394: State Fiscal Stabilization Fund (SFSF) – Education State Grants, Recovery Act (Education Stabilization Fund) – In May 2009, the State was awarded approximately \$778.5 million in ARRA funds under this program. From this amount, the Department has been allocated approximately \$379.7 million. As of November 3, 2009, the Department had received and expended approximately \$90 million of this ARRA grant.

Our consideration of internal control over compliance is for the limited purpose described above and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined in the following paragraph. However, as discussed subsequently, based on the audit procedures performed on the design of internal control over compliance, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency or combination of control deficiencies that adversely affect the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the attached Schedule of Audit Findings and Responses to be significant deficiencies.

A material weakness is a significant deficiency or combination of significant deficiencies that result in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in findings 1, 2, 3, 5, 6, 7, and 8 to be material weaknesses.

Management's response to our findings is included in the accompanying schedule. We did not audit the response and, accordingly, we express no opinion on it.

This interim communication is intended solely for the information and use of the Governor, the General Assembly, the Office of Economic Recovery and Investment, the State Board of Education, management, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

1. SUBRECIPIENT MONITORING NEEDS IMPROVEMENT

The Department did not modify its monitoring plan to ensure that all subrecipients will be monitored timely for the American Recovery and Reinvestment Act (ARRA) funded programs. As a result, there is an increased risk that noncompliance with federal compliance requirements at the subrecipient level will not be detected.

The Department received the grant award notifications for the Special Education and Title I grants in April 2009 and started the application process for the Stabilization grant in July 2009. The Department plans to monitor subrecipients of the ARRA funded programs in conjunction with its existing monitoring plans of other federal programs. The existing plan calls for a site visit or desk review for each subrecipient over a five-year period. Without changing its existing monitoring plan, the Department will not monitor some recipients until years after the ARRA funds have been spent. At the end of October 2009, the Department had awarded subrecipients approximately \$168 million in Recovery Act funds.

Title 34 CFR section 80.40 states that grantees must monitor grant and subgrant activities to ensure compliance with all applicable federal requirements.

Federal Award Information: This finding impacts the ARRA funded programs as follows:

- Title I Grants to Local Education Agencies, Recovery Act: Federal grant number S389A090033 and federal funding period February 17, 2009 – September 30, 2010.
- Special Education Grants to States, Recovery Act: Federal grant number H391A090092 and federal funding period February 17, 2009 – September 30, 2010.
- Special Education – Preschool Grants, Recovery Act: Federal grant number H392A090096 and federal funding period February 17, 2009 – September 30, 2010.
- State Fiscal Stabilization Fund – Education State Grant, Recovery Act: Federal grant number S394A090034 and federal funding period May 20, 2009 – September 30, 2010.

Recommendation: The Department should adjust its monitoring plan to ensure that ARRA funds are monitored timely.

Agency Response: The Department is currently establishing procedures and calendars for performing both onsite visits to ARRA subrecipients and desk reviews for Title I Grants to Local Education Agencies, Recovery Act, Special Education Grants to States, Recovery Act, Special Education – Preschool Grants, Recovery Act and State Fiscal Stabilization Fund – Education State Grant Recovery Act.

2. SEPTEMBER EXPENDITURES OMITTED FROM RECOVERY ACT REPORT

The Department omitted September expenditures from its initial report on the use of the American Recovery and Reinvestment Act (ARRA) funds for the period ended September 30, 2009. Noncompliance with the reporting requirement could be considered a violation of the award agreement. The omission of September data in the report could reduce the usefulness of the data to users as well as cause reconciliation issues with the federal agency.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES (CONTINUED)

Section 1512 of the American Recovery and Reinvestment Act of 2009 requires quarterly reporting on the use of funds. The initial report was to include funding from February 17, 2009 through September 30, 2009 and was due October 10, 2009. The quarterly report submitted by the Department contained data up to August 2009. The Department stated that it did not include September data because it could not reconcile its accounting records for September 2009 by the due date on October 10, 2009. However, federal guidelines state that if recipients cannot reconcile their records by the 10th of the month, they are allowed to make changes to their reports until the 21st day after the end of the quarter to reflect new data available during that period.

The total expenditures reported for these four programs were \$44 million. The September 2009 expenditures not included were approximately \$63 million.

Federal Award Information: This finding impacts the ARRA funded programs as follows:

- Title I Grants to Local Education Agencies, Recovery Act: Federal grant number S389A090033 and federal funding period February 17, 2009 – September 30, 2010.
- Special Education Grants to States, Recovery Act: Federal grant number H391A090092 and federal funding period February 17, 2009 – September 30, 2010.
- Special Education – Preschool Grants, Recovery Act: Federal grant number H392A090096 and federal funding period February 17, 2009 – September 30, 2010.
- State Fiscal Stabilization Fund – Education State Grant, Recovery Act: Federal grant number S394A090034 and federal funding period May 20, 2009 – September 30, 2010.

Recommendation: The Department should comply with federal guidelines by ensuring that the quarterly report includes data for the entire reporting period.

Agency Response: The Department has discussed with the U.S. Government Accountability Office the decision made by the Department (which coincides with the University of North Carolina System and North Carolina Community College System) to report expenditures on the ARRA quarterly reports one month in arrears. This is due to the delay in the receipt of information from the schools, universities and colleges. The Department will seek a formal response from the GAO and the United States Department of Education.

3. FAILURE TO COMPLY WITH FEDERAL SUSPENSION AND DEBARMENT REQUIREMENTS

The Department did not ensure that the federal suspension and debarment requirements were met for subrecipients of the State Fiscal Stabilization Fund – Education State Grant, program. The failure to comply with these requirements heightens the risk that the Department may contract with or provide funds to suspended or debarred subrecipients.

The Department did not verify that any of the subrecipients of the State Fiscal Stabilization Fund were not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System maintained by the General Services Administration, collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity. As of the end of October 2009, the Department had awarded subrecipients approximately \$90 million in State Fiscal Stabilization Funds without obtaining the verification.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES (CONTINUED)

Title 34 CFR section 85.300 requires verification for covered transactions to ensure that the recipients of federal funds are not suspended or debarred. All non-procurement transactions (for example, subawards to subrecipients) according to 34 CFR section 85.210 are covered transactions.

Federal Award Information: This finding impacts federal grant number S394A090034 and federal funding period May 20, 2009 – September 30, 2010.

Recommendation: The Department should establish and implement procedures to ensure compliance with federal suspension and debarment requirements.

Agency Response: The Department will issue an addendum to the assurances requiring subrecipients to sign and return the addendum indicating that they have not been debarred and will not do business with a vendor who has been debarred from doing business with the Federal government.

4. POTENTIAL NONCOMPLIANCE WITH MAINTENANCE OF EFFORT REQUIREMENT

The Department is in jeopardy of not meeting the federal maintenance of effort requirement for the Special Education American Recovery and Reinvestment Act (ARRA) grants for the 2010 fiscal year. As of November 2009 the Department has identified expenditures to be used to meet the requirement; however, the amount identified is \$445,000 less than what is required.

In fiscal year 2009, the Department's expenditures from its own state sources for special education related activities were approximately \$748,000. The Department projected that it would not meet its maintenance of effort for fiscal year 2010 by approximately \$445,000. The Department is planning to use special education expenditures from other state agencies to make up the shortage. As of November 2009, these expenditures had not been identified.

Title 34 CFR section 300.163 states that the State must not reduce the amount of State financial support for special education and related services for children with disabilities, below the amount of that support for the preceding fiscal year.

Federal Award Information: This finding impacts these ARRA funded programs:

- Special Education Grants to States, Recovery Act: Federal grant number H391A090092 and federal funding period February 17, 2009 – September 30, 2010.
- Special Education – Preschool Grants, Recovery Act: Federal grant number H392A090096 and federal funding period February 17, 2009 – September 30, 2010.

Recommendation: The Department should take action to ensure that the maintenance of effort requirement is met in accordance with federal regulations.

Agency Response: The Department is confident that the maintenance of effort requirement for Special Education Grants to States and Preschool Grants will be met.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES (CONTINUED)

Matters Related to Federal Compliance Objectives for Year ended June 30, 2009

During our statewide federal compliance audit procedures for the year ended June 30, 2009, we identified the following findings that could impact the administration of the American Recovery and Reinvestment Act (ARRA) funds in 2010. For finding details and the Department's response, please refer to the audit report on the Department's Statewide Federal Compliance Audit Procedures for year ended June 30, 2009. Summaries of these findings are shown below:

5. DEFICIENCIES WITH SPECIAL EDUCATION CLUSTER SUBRECIPIENT MONITORING

We identified deficiencies in the Department's fiscal monitoring procedures for the Special Education cluster grants. We determined that the Department only monitored 16 out of 43 subrecipients scheduled for monitoring in fiscal year 2009. We also determined that the Department did not send its monitoring reports, including the required corrective action, to subrecipients in a timely manner. If these deficiencies are not corrected by the Department, there is an increased risk that noncompliance with federal compliance requirements for the 2010 ARRA grant could go undetected at the subrecipient level.

Federal Award Information: This finding could impact these ARRA funded programs:

- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H391A090092).
- Special Education – Preschool Grants, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H392A090096).

6. MANAGEMENT DECISIONS NOT ISSUED TO SUBRECIPIENTS

The Department did not issue management decisions on audit findings after receipt of its subrecipients' audit reports. Management decisions are required to clearly state whether the audit finding is sustained, the reasons for the decision, and the expected auditee action. If the Department does not issue formal management decisions, there is an increased likelihood that subrecipients of 2010 ARRA funds will not be able to clearly demonstrate to their auditors or others that their audit findings have been resolved and that the corrective action taken was accepted.

Federal Award Information: This finding could impact these ARRA funded programs:

- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (S389A090033).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H391A090092).
- Special Education – Preschool Grants, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H392A090096).
- State Fiscal Stabilization Fund – Education State Grant, Recovery Act: Federal funding period May 20, 2009 – September 30, 2010 (S394A090034).

SCHEDULE OF AUDIT FINDINGS AND RESPONSES (CONTINUED)

7. FAILURE TO COMMUNICATE ARRA FEDERAL AWARD INFORMATION TO SUBRECIPIENTS

The Department did not make subrecipients aware of all award information and additional compliance requirements associated with the American Recovery and Reinvestment Act (ARRA) funded programs. We determined that the Department did not notify the subrecipients of the federal award numbers and the requirement to provide appropriate identification in their Schedule of Expenditures of Federal Awards and the data collection form. If the Department does not correct this deficiency, there is an increased risk in 2010 of inaccurate reporting of expenditures and noncompliance with the additional compliance requirements associated with the ARRA funds.

Federal Award Information: This finding could impact these ARRA funded programs:

- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (S389A090033).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H391A090092).
- Special Education – Preschool Grants, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H392A090096).
- State Fiscal Stabilization Fund – Education State Grant, Recovery Act: Federal funding period May 20, 2009 – September 30, 2010 (S394A090034).

8. VERIFICATION OF CENTRAL CONTRACTOR REGISTRATION NOT PERFORMED TIMELY

The Department did not determine whether subrecipients had current Central Contractor Registration before awarding them federal funds for the American Recovery and Reinvestment Act (ARRA) funded programs. The Department made the first ARRA awards to subrecipients in April 2009, but it did not require the subrecipients to certify that they had a current Central Contractor Registration until September 2009. If the Department does not take corrective action on this deficiency, there is an increased risk that 2010 ARRA awards will be made to subrecipients without the proper registration.

Federal Award Information: This finding could impact these ARRA funded programs:

- Title I Grants to Local Education Agencies, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (S389A090033).
- Special Education Grants to States, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H391A090092).
- Special Education – Preschool Grants, Recovery Act: Federal funding period February 17, 2009 – September 30, 2010 (H392A090096).
- State Fiscal Stabilization Fund – Education State Grant, Recovery Act: Federal funding period May 20, 2009 – September 30, 2010 (S394A090034).

SCHEDULE OF AUDIT FINDINGS AND RESPONSES (CONCLUDED)

9. ACTION NOT TAKEN ON MAINTENANCE OF EFFORT REQUIREMENT

The Department did not take appropriate action on a subrecipient that did not meet the required maintenance of effort for the Title I Cluster. One subrecipient failed to maintain the required fiscal effort by approximately \$90,000, or 13 percent, of its Title I Cluster allocation. However, the Department did not reduce the subrecipient's allocation of Title I Cluster funds by 13 percent as required by federal regulations until our audit inquiry in November 2009. If the Department does not correct this deficiency, there is an increased risk that noncompliance with regulations will not be corrected.

Federal Award Information: This finding could impact Title I Grants to Local Education Agencies, Recovery Act for federal funding period February 17, 2009 – September 30, 2010 (S389A090033).

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