

September 2010

# RECOVERY ACT

## Opportunities to Improve Management and Strengthen Accountability over States' and Localities' Uses of Funds (North Carolina)



GAO

Accountability \* Integrity \* Reliability

---

# Appendix XIV: North Carolina

---

## Overview

The following summarizes GAO's work for the seventh of its bimonthly reviews of the American Recovery and Reinvestment Act of 2009 (Recovery Act)<sup>1</sup> spending in North Carolina. The full report covering all of our work in 16 states and the District of Columbia is available at <http://www.gao.gov/recovery>.

---

## What We Did

Our work in North Carolina focused on gathering information about 2 programs funded under the Recovery Act—the Early Head Start Program and the Public Housing Capital Fund. We also reviewed the use of Recovery Act funds for budget stabilization in one local community and at the state level, and monitoring and reporting within the accountability community. For descriptions and requirements of the programs we covered, see appendix XVIII of [GAO-10-1000SP](#).

- For the Early Head Start program, we visited two grantees—Guilford Child Development (GCD) and Johnston-Lee-Harnett Community Action, Incorporated (JLHCA). We selected GCD, which is expanding an existing Early Head Start program, because it received the largest amount of Early Head Start Recovery Act funds in North Carolina and the largest amount of Recovery Act funds for the renovation or construction of facilities. We selected JLHCA because it was using Early Head Start Recovery funds to implement a new Early Head Start program. During our visits, we spoke with senior program and fiscal officials about how they were spending their Early Head Start Recovery Act funds. We also reviewed a selection of each program's Early Head Start files to assess how the grantees documented enrollment, eligibility, and certain required health screenings.
- For the Public Housing Capital Fund we visited two public housing agencies—Charlotte Housing Authority (CHA) and Beaufort Housing Authority (BHA)—to determine how funds were being used. We selected CHA because it received the largest capital grant allocation. We selected BHA because it received one of the smallest grant allocations in North Carolina. We interviewed the housing officials and performed testing of expenditures and examined accounting records and external audit documentation. Additionally, we interviewed Department of Housing and Urban Development (HUD) officials in Greensboro, North Carolina, regarding their oversight of Recovery Act

---

<sup>1</sup>Pub. L. No 111-5, 123 Stat. 115 (Feb. 17, 2009).

funds and their procedures for assisting and monitoring public housing agencies in administering these funds.

- We interviewed state budget officials in North Carolina's Office of State Budget and Management (OSBM) to gather information about the state's use of Recovery Act funds and fiscal condition, including challenges to future economic recovery. We selected the City of Wilmington for a local budget review in order to assess the impact Recovery Act funds are having at the local government level. Located in the southeastern section of the state, Wilmington is one of the largest cities in North Carolina and its unemployment rate is below the state's average. We asked both state and local officials to discuss: (1) the amount of Recovery Act funds its entity is expected to receive, (2) how the funds are being used and their potential impacts, and (3) whether the officials have plans for when Recovery Act funds are no longer available.
- To obtain an update on the monitoring of Recovery Act funds by North Carolina's accountability community since our last report, we interviewed senior administrators with the North Carolina Office of the State Auditor (OSA), Office of Economic Recovery and Investment (OERI), and OSBM's Office of Internal Audit (OIA).

---

## What We Found

- **Early Head Start.** Nineteen Early Head Start grantees in North Carolina received about \$24.2 million in Early Head Start Recovery Act expansion funds for the first year of a 2-year grant period. Overall, while both grantees are spending their Recovery Act funds, we found that they were at risk of not spending their entire first-year grants by the end of fiscal year 2010, as required. GCD's senior officials reported that they would have an estimated \$336,882 of unspent funds this year due to delays with construction and hiring. Senior officials for JLHCA reported that a delay in receiving the grant award would leave them with about \$75,000 to \$100,000 of unspent personnel funds. Officials representing both grantees reported that they will request that OHS approve a carryover of the unspent funds into fiscal year 2011. Despite the delays, GCD and JLHCA officials reported having created jobs with their Early Head Start Recovery Act funds for the reporting period April 1, 2010, to June 30, 2010.
- **Public Housing Capital Fund.** We found internal control weaknesses related to procurement practices using Recovery Act funds at both PHAs we visited. We also found that one of the two PHAs we visited did not maintain proper documentation of its use of

Recovery Act funds. Specifically, at CHA we found that officials did not follow their procedures for reconciling and approving monthly purchase card transactions, including documenting reviews of statements by approving officials and providing training to card holders. We also found that BHA did not maintain proper documentation of its use of Recovery Act funds. Although BHA received a Recovery Act public housing capital fund formula grant of approximately \$201,000, we were unable to determine how those funds were used. BHA officials did not provide a general ledger or properly track the use of Recovery Act funds. In our review of the documentation supporting the external audit, we found significant departures from auditing standards. In addition, we found that the BHA board's oversight practices did not meet its own standards.

- **State and local budget stabilization.** As state officials begin to work on the 2011-2013 biannual budget, state budget officials project nearly a \$3 billion budget shortfall that will likely have to be dealt with through budget cuts or revenue enhancements. Wilmington officials told us that \$8.1 million in Recovery Act grants it received provided much needed extra funding for some city projects and services, but did not affect many other departments that had budget reductions. Wilmington officials raised property taxes and used the city's fund balance to balance its budget.
- **Accountability.** We learned that in addition to Single Audits, North Carolina's oversight entities—OSA, OERI and OIA—conduct a range of work to ensure recipients' compliance with applicable laws and regulations. For example, since our May 2010 report, OSA completed a review related to the North Carolina Department of Environment and Natural Resource's compliance with Davis-Bacon provisions of the Recovery Act. OERI officials reported working with state agencies to implement their corrective action plans in response to OSA findings in reports issued in 2010 as well as monitoring compliance among the state's recipients and subrecipients of Recovery Act funds with Recovery Act and OERI requirements related to procurement. Finally, since our May 2010 report, OIA issued a report on several state agencies' compliance with state and federal regulations applicable to the Recovery Act State Fiscal Stabilization Fund (SFSF) and issued risk assessments of Recovery Act programs in three agencies.

---

## North Carolina Grantees are Spending Early Head Start Recovery Act Expansion Funds, but Also Report Spending and Implementation Delays

The Office of Head Start (OHS), a part of the U.S. Department of Health and Human Services' (HHS) Administration for Children and Families awarded 19 Early Head Start grantees in North Carolina about \$24.2 million in Early Head Start expansion funds provided under the Recovery Act for the first year of a 2-year grant period.<sup>2</sup> For the second year of funding, OHS has committed an estimated \$19.4 million in Recovery Act funds to North Carolina's 19 grantees receiving Recovery Act funds.<sup>3</sup> The Recovery Act appropriated these funds for the costs to expand the number of families served by Early Head Start. The allowable expenditures include salaries for new staff, renovation and construction of facilities, and training and technical assistance for new and existing Early Head Start staff. For the 2-year period, Recovery Act funds are to support Early Head Start services for up to 1,556 infants, toddlers, and pregnant women in the state.

In June 2010, we visited two grantees—Guilford Child Development (GCD) and Johnston-Lee-Harnett Community Action, Incorporated (JLHCA)—to review Early Head Start Recovery Act spending. At both programs, we spoke with senior program and fiscal officials responsible for the implementation of the Early Head Start expansion activities. We also reviewed each program's Early Head Start files to assess how the grantees documented enrollment, eligibility, and certain required health screenings.<sup>4</sup> We selected GCD, which is expanding an existing Early Head Start program, because it received the largest amount of Early Head Start Recovery Act funds in North Carolina and the largest amount of Recovery Act funds for the renovation or construction of facilities. We selected JLHCA because it was using Early Head Start Recovery Act funds to implement a new Early Head Start program.

---

<sup>2</sup>Recovery Act, 123 Stat.178-79 (2009). For grantees in North Carolina, the first year of their Early Head Start expansion grant awards generally began on December 1, 2010, and ends on September 29, 2010. The second year of funding begins on September 30, 2010, and ends September 29, 2011.

<sup>3</sup>This amount represents an estimate since an OHS review of first-year spending and future needs may modify the second-year funding amounts for individual grantees.

<sup>4</sup>We randomly chose our sample from files on all children the grantees reported were enrolled in the Early Head Start program funded under the Recovery Act in the month of April 2010. For GCD, we reviewed 23 of 80 files. For JLHCA, we reviewed 10 of 31 files. For documentation of health screenings, we limited our review to documentation of sensory (vision and hearing), motor, and developmental screenings.

Overall, officials representing both grantees told us that they were spending their first-year Recovery Act funds to expand Early Head Start services through the renovation or construction of new facilities, hiring staff, and training the newly hired staff. However, at the time of our visits, neither grantee anticipated spending their entire first year Early Head Start Recovery Act grant award by the end of fiscal year 2010, as required by OHS. Both grantees also identified other challenges in implementing their Early Head Start programs funded under the Recovery Act programs. Finally, both grantees reported having created jobs for the April 1 through June 30, 2010, recipient reporting period.

---

**Construction Challenges  
Delay Guilford Child  
Development's  
Implementation of Center-  
Based Program**

GCD received about \$3.2 million in Early Head Start Recovery Act funds for its first year. HHS designated these funds for GCD to provide services to an additional 104 infants, toddlers, and pregnant women in Guilford County, which includes the cities of High Point and Greensboro.<sup>5</sup> GCD officials told us they used these funds to renovate one child care center, build another child care center, and provide professional development training and salaries for staff, and for other purposes. At the time of our visit, GCD officials reported that work was incomplete for both centers. The Bristol center, designated for 32 children in the Greensboro area, should open by September 2010, according to GCD officials. Construction of the Arlington center should serve 48 children, also in the Greensboro area. Program officials told us that the Arlington Center has faced significant delays and is not scheduled to open until September 2011. GCD officials attributed some of the delays in the Arlington center to problems in securing the original sites identified in the spending proposal submitted to OHS and the process for receiving approvals for the change in facility location from OHS.<sup>6</sup> Regional OHS officials confirmed that the delay for the Arlington center was due to GCD's challenges in securing sites and attributed the delay in the OHS approval process to having to wait for GCD's contractors to provide documentation needed by OHS to complete the review and grant approval.

---

<sup>5</sup>Of these 104 slots, 80 are for infants and toddlers and 24 are for pregnant women participating in GCD's nurse partnership program.

<sup>6</sup>According to a GCD official, the organization's attempts to acquire two facilities prior to selecting the Arlington center failed. These officials told us that a local school board with approval authority over the first center GCD sought to purchase voted against selling the facility and concerns over the terms of a lease contributed to the failure of acquiring the second facility.

GCD officials also reported to us that while waiting for the two Recovery Act-funded centers to open, they implemented a temporary home-based program for children receiving services<sup>7</sup>. They also told us they have delayed hiring staff for the Arlington center. According to these officials, the lower costs associated with the home-based program and unspent personnel and benefits funds primarily due to the construction delays may leave \$336,882 of unspent funds at the end of fiscal year 2010.<sup>8</sup> These officials told us that they are seeking approval from OHS to use these unspent funds to cover additional construction costs on the Bristol center and “green” improvements, such as solar panels and energy efficient windows, to both the Bristol and Arlington centers. Alternatively, GCD officials said that if they do not receive approval to reallocate the funds so that they can spend all of the fiscal year 2010 funds, they will request approval from OHS to carry over the funds into fiscal year 2011. In July 2010, regional OHS officials told us that staff in OHS’s headquarters would make decisions about procedures for carryover requests related to the Recovery Act funds but that such procedures had not yet been determined.

GCD officials reported that the temporary home-based program for infants and toddlers is new for their organization, and while they have operated other home-based programs, implementation of the new program has presented some challenges. These senior program and fiscal officials said they anticipated using the home-based option for the Bristol center for 5 months, instead of the estimated 7 months, until the center opens in September 2010. As previously mentioned, the Arlington center is not scheduled to open until the end of the grant period—September 2011. As a result, any children waiting to use the Arlington center will spend the

---

<sup>7</sup>Providing services through a home-based program is an approved service delivery method for the Early Head Start program. 45 C.F.R. § 1306.33. According to an OHS tip sheet about Early Head Start, the home-based service delivery method involves Early Head Start staff visiting a family’s home every week to support child development and to nurture the parent-child relationship. Twice a month, the program offers opportunities for parents and children to come together as a group for additional learning, discussion, and social activity.

<sup>8</sup>At the time of our review in June 2010, the estimated amount of unspent funds was \$344,142 which included salary costs for a nurse for the component of GCD’s program for pregnant women. GCD officials said that they were recruiting pregnant women but could not start the program until they hired a nurse. These officials reported challenges in meeting the salary demands of experienced nurses in the area. In July 2010, a GCD official reported having hired a nurse and said that the nurse would begin providing services in August 2010. A GCD official said that the costs associated with hiring this nurse would reduce the amount of unspent funds they reported at the time of our visit by about \$7,320.

entire Recovery Act grant period receiving home-based services rather than the intended center-based services.<sup>9</sup> GCD officials said the primary challenge they faced in using the home-based program for such a length of time is that families in the communities it serves are not interested in home-based child care services. These officials attributed the lack of interest to the requirement that parents be present in the home for weekly visits, which is difficult for working families. As a result, GCD officials told us, some families have opted to remain on a waiting list until the centers open, but other families have dropped out of the program.

GCD also faced challenges developing timely policies and procedures for the home-based program and consistently including documentation related to enrollment and health screenings in its files. GCD officials told us that their organization's governing board did not approve formal policies and procedures on such issues as documenting or determining attendance for its home-based program until June 2010, several months after the program had been operating. Prior to the formalization of these policies, GCD said its staff used different methods for documenting attendance during the weekly home visits. Further, while we observed that all of the files we reviewed had verification, with two staff signatures, of income eligibility, the inclusion of clear documentation in the files to show date of enrollment and some of the required health screenings was inconsistent among the files we reviewed<sup>10</sup>. For example, we did not see clear documentation noting enrollment dates (with which to compare to the monthly enrollment data) in any of the files we reviewed. Rather, GCD officials said that the date a family completed an enrollment packet comprised of selected health and parental agreement documents<sup>11</sup> and the inclusion of these documents in three colored folders represented

---

<sup>9</sup>Regional OHS officials told us that OHS approved of GCD's use of the home-based option for the Recovery Act program because, in part, the grantee has had experience in providing home-based services.

<sup>10</sup>Grantees must maintain on file documentation that children enrolled received health screening for developmental, sensory, and behavioral concerns within 45 days of entering the program and that income eligibility was verified. 45 C.F.R. §1304.20(b)(1) and 1305.4(e). OHS also requires grantees to submit enrollment reports on a monthly basis, and auditors compare on-site enrollment data with these reports during program audits.

<sup>11</sup>GCD officials reported that the inclusion of the following documents constituted enrollment: arrival and departure agreements; attendance agreement; health history (filled out by parents); nutrition assessment; Sudden Infant Death Syndrome (SIDS) policy and oral health certification; Child & Adult Care Food Program (CACFP) form; screening consent and records; and signed notice of privacy practices.

enrollment.<sup>12</sup> However, given the range of documents needed to establish an enrollment date, we did not attempt to assess the completeness of the files or whether or not an enrollment date could be determined. In 7 of the 23 files we reviewed, we did not see documentation of at least one of the three required health screenings within the 45-day time period. We also observed inconsistencies in the inclusion of documents related specifically to home visits, such as a home visitation agreement, in the files we reviewed.<sup>13</sup> GCD officials said that some home visitors retain the home visitation agreements in their offices while others include the forms in the child's file. GCD officials acknowledged the inconsistencies in the inclusion of documents in the files and told us that while they had met the requirements, they had already begun to implement more consistent administrative practices for documentation related to their home-based program.

---

<sup>12</sup>Enrollment is defined by regulation as official acceptance of a family by a program and completion of all procedures necessary for a child and family to begin receiving services. 45 C.F.R. §1305.2(b). GCD officials said that enrollment is, in part, designated by three colored folders that contain documents related to income eligibility (a red folder), required health screenings (a yellow folder), and education-related information (a blue folder), which are all necessary for enrollment. They told us that children who were terminated from the program do not have all three folders in their file.

<sup>13</sup>Grantees are required to offer parents opportunities to develop and implement individualized family partnership agreements that describe family goals, responsibilities, timetables and strategies for achieving these goals as well as progress in achieving them. 45 C.F.R. §1304.40(a)(2). In home-based program options, this agreement must include the above information as well as the specific roles of parents in home visits and group socialization activities. The GCD home visitation agreement we reviewed included such topics as attendance, frequency of home visits, procedures for absences, and participation in social activities.

---

Johnston-Lee-Harnett  
Community Action,  
Incorporated Reports  
Challenges in  
Implementation of New  
Early Head Start Program

JLHCA received about \$1.5 million in Early Head Start Recovery Act funds for its first year of funding. HHS designated these funds for JLHCA to create a new Early Head Start program that would serve 80 infants, toddlers, and pregnant women in Johnston, Lee, and Harnett counties.<sup>14</sup> According to officials, JLHCA used these funds to lease and renovate three day care centers,<sup>15</sup> for staff professional development such as curriculum and skills training, and for salaries and resource materials. JLHCA did not receive Recovery Act funds specifically for construction and renovation of facilities.<sup>16</sup> Therefore, JLHCA officials told us that they were using \$443,200 from their Recovery Act start-up budget to renovate one center in each of the three counties the organization serves, an allowable use of the funds. At the time of our visit, JLHCA had been delivering Early Head Start services in Johnston County since April 2010 and in Lee County since May 2010. It was awaiting the completion of roof repairs and kitchen renovations in a center in Harnett County, which opened in August 2010. Regional OHS officials with knowledge of JLHCA's implementation progress attributed delays in Harnett County to JLHCA having had limited experience with providing services in the county. At the time of our visit, JLHCA was not yet providing Early Head Start services to children in Harnett County and officials attributed the delay to the slow process for obtaining facility permits, and receiving their grant award later than expected. JLHCA officials said that while they had expected to receive notification of their grant in October 2009, the organization did not receive grant award notification from OHS until the end of December 2009. Additionally, while their budget included salaries for staff from December to February, the officials did not begin hiring staff for all centers until March 2010. These officials reported that, due to the delay in the grant award, an estimated \$75,000 to \$100,000 in personnel, benefits, and indirect costs for the 3-month period could go unspent by the end of the fiscal year. JLHCA officials told us that they were seeking approval from OHS to transfer these funds from their operating account into their supplies account so that they could use the funds for such items as diapers and formula or to make improvements to the playground areas of the

---

<sup>14</sup>According to JLHCA officials, 60 of the 80 slots are reserved for infants and toddlers and 20 of the slots are reserved for pregnant women.

<sup>15</sup>JLHCA officials also said that they purchased a facility in Lee County using their non-federal funds. They are using funds from their Recovery Act start-up budget to lease the facilities used for Early Head Start services in Johnston and Harnett counties.

<sup>16</sup>OHS provided some grantees, such as Guilford Child Development, with Recovery Act funds specifically for the purpose of construction of facilities in addition to their start-up funds.

---

Recovery Act-funded centers. JLHCA officials reported that they will also apply for OHS approval to carry over the funds into fiscal year 2011.

In addition to the delays in receipt of the grant award and opening of one of its facilities, JLHCA officials also reported challenges in recruiting pregnant women for their Early Head Start program and expressed concerns over sustaining the program once Recovery Act funds end. JLHCA officials told us that while there is a waiting list for children, the organization has been slow in meeting its funded slots for pregnant women due to a lack of familiarity with and interest in the program among this population. As a result, at the time of our interview JLHCA had recruited 8 pregnant women for its funded 20 slots for this portion of its Early Head Start Recovery Act program. Although JLHCA is spending 29 percent of its first year grant on the lease and renovation of the three facilities, we found that JLHCA did not have a plan in place for sustaining its Early Head Start program once Recovery Act funds end in 2011. JLHCA officials said that without additional Recovery Act funds or local or state funding they would have to close the three Early Head Start programs. While officials reported to us several alternatives for retaining the facilities—such as using the facilities for Head Start or for-profit child care centers—they did not provide alternatives for maintaining the services for infants and toddlers created with Recovery Act funds.

Our file review did not reveal any deficiencies in how JLHCA documents enrollment, income eligibility, and the three required health screenings we reviewed.

---

### Grantees Report Job Creation with Early Head Start Recovery Act Funds

GCD and JLHCA senior program and fiscal officials reported having funded jobs with their first year Early Head Start Recovery Act funds. GCD officials said that for the April 1, 2010, to June 30, 2010, reporting cycle, they reported 9.86 new full-time equivalents. These positions include 7 teachers, a center director, a nurse home visitor, and a family advocate. GCD also reported 1.5 full-time equivalents for construction on its Bristol center. JLHCA officials said that they reported 5 new full-time equivalents. They told us that these positions include 1 center director, 3 teachers, 1 family service worker, and 1 custodian.<sup>17</sup> GCD and JLHCA officials also

---

<sup>17</sup>A JLHCA official reported that, in total, the organization has funded 18 jobs since receiving Early Head Start Recovery Act funds.

said that they did not experience any problems with the recipient reporting process.

---

## Internal Control and Oversight Weaknesses Increase Risk of Mismanagement of Recovery Act Public Housing Funds

North Carolina's 99 public housing agencies (PHA) received approximately \$83.4 million from the Recovery Act public housing capital formula grant—the federal government provides these funds directly to local PHAs. HUD oversight of these programs is carried out by its field offices. We visited 2 PHAs in North Carolina—Beaufort Housing Authority (BHA) and Charlotte Housing Authority (CHA)—to determine how they were planning to use these funds. At each PHA, we interviewed officials about procurement practices with respect to Recovery Act funds and performed expenditure testing. The testing included a review of accounting records and the sufficiency of supporting documentation, including invoices. We also attempted to review the appropriateness of the expenditures at BHA based on the grant agreements and applicable laws and regulations. We selected CHA because it received the largest Recovery Act capital fund grant allocation—about \$7.5 million—in North Carolina and BHA because it received one of the smallest allocations—about \$201,000. We also interviewed HUD officials about their procedures for assisting and monitoring PHAs management and use of the funds. As of August 2010, BHA had drawn down its entire award. As of August 7, 2010 CHA had obligated its entire \$7.5 million award.<sup>18</sup>

Housing authority officials at both PHAs told us they planned to use Recovery Act funds for a variety of housing rehabilitation projects and security enhancements. During our initial visit in October 2009 to CHA, officials told us they planned to use Recovery Act funds to rehabilitate 609 units by replacing 522 water heaters and appliances and improve security by installing site-security poles and Internet cameras at 22 sites. During our October 2009 visit, BHA officials told us they rehabilitated 4 units and a community center with the Recovery Act funds they were allocated.

We found internal control weaknesses related to procurement practices using Recovery Act funds at both of the PHAs we visited. We also found

---

<sup>18</sup>An obligation is a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States. Payment may be made immediately or in the future. Drawdowns occur after a grant award has been made and the recipient requests the transfer of funds to a grantee's account for its immediate cash program needs.

that one of the two PHAs we visited did not maintain proper documentation of its use of Recovery Act funds. In addition, the HUD Office of Inspector General (OIG) has found that a third PHA in North Carolina failed to comply with procurement and financial management requirements in its administration of Recovery Act funds. As a result, the HUD OIG concluded the third PHA could not provide assurance that it properly awarded more than \$2.4 million for contracts or that it had the capacity to administer funds in accordance with the grant and Recovery Act requirements.

---

### Charlotte Housing Authority Internal Controls Could Be Strengthened to Prevent Abuse

CHA procurement office officials told us they had designed strong internal controls to prevent and detect fraud, waste, and abuse from occurring in the PHA's credit card program. However, we identified internal control weaknesses that left Recovery Act and other federal funds vulnerable to fraud, waste, and abuse.

According to CHA officials, CHA has put in place several requirements to ensure proper use of purchase cards by CHA employees. For example, CHA officials said that each month cardholders are responsible for reconciling their monthly purchase card statement with a purchase order that should have been approved prior to the purchases being made. Cardholders must also ensure individual transactions are charged to the applicable grant account, according to CHA officials. Cardholders are required to submit their reconciled statement with all supporting documentation to the purchase card administrator office for approval. CHA cardholders are also required to meet in person with a procurement official for a review of the purchase card statement and supporting documentation. During this review, each transaction on the statement is to be matched to original receipts and an item-by-item match is made with an approved purchase order, according to CHA officials. CHA officials also reported that CHA's policies and procedures state that it is the responsibility of the approving official to review the transactions of those purchase card holders who directly report to them and report irregularities to the procurement office.

However, during our review of the purchase card documentation, we did not find any evidence that transactions had been reviewed by approving officials, and therefore could not verify that the reviews had been conducted. CHA's Acting Chief Operating Officer agreed that there is a need for approving officials to document their review of purchase card transactions. In addition, one of the purchase card administrators told us all cardholders and approving officials are required to take a purchase

---

card training course before they receive a purchase card. However, one purchase card holder stated she had not received purchase card training and no one told her what she could or could not buy with the card.

---

**Beaufort Housing  
Authority Officials  
Provided False  
Information to GAO  
Auditors**

BHA received a Recovery Act public housing capital fund formula grant of approximately \$201,000. We interviewed BHA senior officials and staff and examined BHA bank records to determine how the PHA used Recovery Act funds. However, because BHA officials did not provide a general ledger or properly track the use of Recovery Act funds, we were unable to determine how those funds were used. BHA officials also failed to provide us sufficient documentation related to the 4 housing units and one community center they claimed were rehabilitated with Recovery Act funds. Additionally, BHA officials provided documents to us during our review that we later learned were false. As a result, we have serious concerns about the possibility that Recovery Act funds were misused and have referred this matter to the HUD OIG.

When we met with BHA officials, we were told that approximately \$191,000 of the grant funds had been paid to one contractor to perform renovation work on four housing units and a community center. We were also told the contract for this work was awarded after a competition in which BHA officials solicited bids from several contractors. As support for these assertions, BHA officials provided us with solicitations purportedly sent by BHA to seven contractors. However, upon further inquiry we learned that the solicitations were fictitious: we learned they were never sent out but were created for the purpose of misleading GAO auditors into believing that they were evidence of a competition.

The bank records of BHA also contain information that raises serious concerns about misuse of Recovery Act funds. For example, on two occasions after Recovery Act funds were deposited into the BHA account, the Executive Director of BHA prepared and signed several checks made payable to her, which appear to be diversions of BHA funds for personal use. We are working with the HUD OIG to assist in a full investigation of this matter.<sup>19</sup>

---

<sup>19</sup>The Executive Director was subsequently dismissed by the BHA board. On January 2010 she was charged in Carteret County District Court of the State of North Carolina with embezzlement of BHA funds and corporate malfeasance. The case is currently pending.

---

### Insufficient Oversight May Have Contributed to Weak Control Environment

BHA's annual external audit, its Board of Commissioners, and HUD are the key components of the oversight structure for BHA's fiscal management. However, in our review of the documentation supporting the external audit we found significant departures from auditing standards. We also found that the board's oversight practices did not meet its own standards. For its part, HUD field office conducted on-site reviews of BHA in 2006, 2007, 2009, and 2010. Some of those reviews identified deficiencies in management.

---

### Departures from Professional Standards Identified in Review of External Audits

Due to the significant internal control weaknesses we identified in BHA's disbursement of and procurement processes over Recovery Act funds discussed above, we reviewed the audit reports and supporting documentation for BHA's fiscal year 2006, 2007, and 2008 financial statement audits. During those years, BHA received federal funds and two of the auditor reports identified internal control issues similar to the issues we identified in our review of Recovery Act funds. Our review of the prior years' audit reports and supporting audit documentation identified substantive issues in the quality of the audit documentation and the extent to which the documentation satisfactorily complied with applicable audit standards.<sup>20</sup> These departures from auditing standards significantly weakened the ability of BHA's Board of Commissioners, and ultimately HUD, to ensure that the BHA maintained an effective control environment to reduce the risk of fraud, waste, or abuse over the expenditure of federal funds, including Recovery Act funds. We identified six areas of concern, that in our opinion, BHA's external auditor departed from generally accepted government auditing standards (GAGAS)<sup>21</sup> and standards promulgated by the American Institute of Certified Public Accountants (AICPA)<sup>22</sup>:

- Insufficient Evidence to Support Closing of Prior Year Findings
- Insufficient Evidence to Support Adequate Consideration of Fraud
- Insufficient Audit Documentation

---

<sup>20</sup>The fiscal year 2006, 2007, and 2008 BHA financial statement audits were all performed by the same auditor.

<sup>21</sup>Generally accepted government auditing standards are issued by the Comptroller General of the United States and are published in a guide, commonly referred to as the "Yellow Book." The citation for this guide is GAO, *Government Auditing Standards*, [GAO-07-731G](#) (Washington, D.C.: July 2007).

<sup>22</sup>As a Certified Public Accountant, the auditor must comply with AICPA standards.

- Lack of Supervisory Review
- Inadequate Analytical Procedures
- Insufficient Disbursement Testing to Support Auditor's Conclusions

The fiscal year 2006, 2007, and 2008 BHA financial statement audits were performed by the same auditor. On August 18, 2010, we formally transmitted the results of our review of the work of BHA's external auditor to the North Carolina State Auditor for consideration of further action. We discuss the six areas in which we identified concerns in greater detail below.

- **Insufficient Evidence to Support Closing of Prior Year Findings.** We found that all of the fiscal year 2006 findings were reported as closed without explanation in BHA's 2007 audit report. Based upon our subsequent review of the auditor's fiscal year 2007 audit documentation, we concluded that there was insufficient evidence to support the closing of the fiscal year 2006 audit findings in several instances.<sup>23</sup> For example, we found insufficient evidence in the fiscal year 2007 audit documentation to support the closing of the fiscal year 2006 audit finding related to the violation of procurement policy. According to BHA officials, contracts over \$100,000 should be performed by a sealed bid process. In his fiscal year 2006 audit report, the auditor stated that he found no evidence that this sealed bid process was followed for a capital fund improvement contract. However, the auditor reported this finding as closed in the fiscal year 2007 audit report, based on management's response that "the Authority realizes the significance of following the provisions of the procurement policy and is committed to doing so in the future" and the auditor's conclusion that there were no contracts over \$100,000 in fiscal year 2007. No evidence was in the audit documentation to support the auditor's conclusion.

Further, we question the closing of another finding related to the incomplete and inaccurate tenant file documentation without sufficient evidence. Tenant file documentation for public housing should include income verification, apartment inspection, rent calculation, security deposit information, a signed lease, and certain forms required by HUD. The auditor, in the fiscal year 2006 audit report, recommended that BHA should (1) make certain personnel

---

<sup>23</sup>GAGAS paragraph 4.09 states that auditors should evaluate whether the audit entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements.

responsible for the tenant files receive adequate training, (2) hire a specialist to review all the tenant files to make appropriate corrections, and (3) develop a system to ensure accurate information for the future. Our review of the fiscal year 2007 audit documentation found the recommendation was closed because BHA hired a new employee who would be responsible for tenant files. However, BHA had not trained or scheduled training or hired a specialist to perform on-site file reviews and training. Notably, in the fiscal year 2008 audit report, inadequate tenant documentation was again identified as a finding with the recommendation that management ensure those responsible for tenant applications be adequately trained. The auditor, in the fiscal year 2008 audit report, further recommended that BHA contract with a consultant or other public housing authority to provide initial training.

- **Insufficient Evidence to Support Adequate Consideration of Fraud.** We found insufficient evidence to support adequate consideration of fraud in the audit. During our May 2009 visit, the BHA Executive Director at that time told us that she was hired to replace the former BHA Executive Director, who had resigned and was subsequently charged in July 2006 with embezzlement of BHA property.<sup>24</sup> The AICPA Statements on Auditing Standards, AU Section 316, *Consideration of Fraud in a Financial Statement Audit*, require the auditor to obtain information needed to identify risks of material misstatement due to fraud by: (1) inquiring of management and others within the entity about the risks of fraud; (2) considering the results of the analytical procedures performed in planning the audit; (3) considering fraud risk factors; and (4) considering certain other information. Among other things, the auditor should inquire whether management has knowledge of any fraud or suspected fraud affecting the entity and the monitoring of programs and controls which have been established to mitigate specific fraud risks the entity has identified, or that otherwise help to prevent, deter, and detect fraud. Auditing standards also require auditors to perform audit procedures in response to identified risks of material misstatements due to fraud, and the auditor's responses to address identified risks of material misstatement due to fraud may include changing the nature, timing, and extent of audit procedures. Further, the auditor is required to document a description of the auditor's responses to those identified

---

<sup>24</sup>The former Executive Director pled guilty on May 6, 2008, to one count of employee larceny and 16 counts of embezzlement.

risks. In addition, the auditor should also design audit procedures to further address the risk of management override of controls and then document the results of the procedures that were performed.

The audit documentation prepared by BHA's external auditor during the fiscal year 2008 audit showed he interviewed the BHA Executive Director at that time about fraud. His interview notes stated she was unaware of any instances of fraud and everything was in order because it all ultimately comes to her. The auditor's documentation also reported that the then BHA Executive Director said everyone was aware of the embezzlement by the previous Executive Director. The audit documentation indicated the auditor interviewed another employee, the then assistant to the Executive Director.<sup>25</sup> The interview notes stated that the then assistant was not aware of any instances of fraud and did not suspect any fraud. According to his fraud risk inquiries form, which lists the names of these two individuals he interviewed about fraud, there is no evidence that the auditor interviewed the Board of Commissioners about the risks of fraud and whether they had an active role in the oversight of BHA's assessment of the risks of fraud and the programs and controls established to mitigate those risks. Further, this documentation did not contain any identified fraud risks associated with his discussions. In our opinion, due to the auditor's knowledge of the past embezzlement at the BHA, his professional skepticism as an auditor should have been heightened to, at a minimum, perform procedures to address the risk of management's override of controls.

- **Insufficient Audit Documentation.** In general, the audit documentation was not sufficient to enable an experienced auditor, having no previous connection to the audit, to understand the work performed, the audit evidence obtained, and the conclusions reached. Under AICPA standards and GAGAS paragraph 4.19,<sup>26</sup> auditors must prepare audit documentation in connection with each audit in sufficient detail to provide a clear understanding of the work performed (including the nature, timing, extent, and results of audit procedures performed), the audit evidence obtained and its source, and the conclusions reached. Furthermore, the AICPA Statement on Auditing Standards, AU Section 339.18, states that auditors should

---

<sup>25</sup>This employee later became the Manager of Administration.

<sup>26</sup>[GAO-07-731G](#).

record who performed the audit procedures and when such work was completed.

In addition to the lack of supervisory review, discussed below, most of the audit documentation that we reviewed for the audits of both fiscal year 2007 and fiscal year 2008 was missing at least one of the following key elements of an audit document: the preparer of the document, the date the work was performed, or the conclusion reached. Further, none of the audit documentation that we reviewed indicated the auditor's purpose in preparing the document, and few documents indicated the source of the work, making it difficult to determine why the work was performed or the origin of the audit evidence. Without this documentation, the nature, timing, extent, and results of audit procedures performed cannot be determined, as required by GAGAS.

- **Lack of Supervisory Review.** In the audit documentation that we reviewed for audits of both fiscal year 2007 and 2008, there was no evidence of supervisory review. According to GAGAS paragraph 4.20,<sup>27</sup> auditors should document, before the audit report is issued, evidence of supervisory review of the work performed that supports findings, conclusions, and recommendations contained in the audit report. The external auditor did not document his justification or rationalization for this departure from GAGAS, nor did he document how the alternative audit procedure he performed was sufficient to achieve the intent of a supervisory review of the audit documentation.
- **Inadequate Analytical Procedures.** The external auditor employed inadequate analytical procedures for the fiscal year 2008 audit. According to AICPA standards, AU section 329, the objective of analytical procedures, used in the overall review stage of the audit, is to assist the auditor in assessing the conclusions reached and in the evaluation of the overall financial statement presentation. This review includes considering any unusual or unexpected balances that were not previously identified. Results of an overall review may indicate that additional evidence may be needed. However, the audit documentation we reviewed did not include any record of management's response to the unusual or unexpected balances or an assessment of the adequacy of such a response. Further, the audit documentation did not include an assessment that additional evidence was needed or additional audit procedures were considered.

---

<sup>27</sup>[GAO-07-731G](#).

The external auditor issued a concluding letter, dated June 10, 2009, regarding the audit of the BHA fiscal year 2008 financial statements addressed to the BHA Board of Commissioners. In this letter, he stated that when comparing the fiscal year ended September 30, 2008, actual expenditures to those in the approved budget, there was an unfavorable variance of \$35,561 (that is, actual expenditures exceeded the budgeted expenditures by \$35,561). According to the audit documentation, this was a significant variance with respect to the magnitude of BHA's budgeted expenditures. Furthermore, the auditor noted that he found significant unfavorable variances in the expense categories of administration, ordinary maintenance, and general expense. However, the audit documentation we reviewed did not include any record of management's response to the unusual or unexpected balances or an assessment of the adequacy of such a response. Further, the audit documentation did not include an assessment that more evidence was needed or additional audit procedures were considered.

- **Insufficient Disbursement Testing to Support Auditor's Conclusions.** During our review of the internal control testing of disbursements performed as part of the fiscal year 2008 audit, we found insufficient support for conclusions reached by the external auditor on vendor payment testing which consisted of 2 payroll and 25 non-payroll transactions. The external auditor's testing document indicated that there were no exceptions; and the external auditor, therefore, concluded that vendor payments appeared proper and consistent with the processes established by BHA.

The external auditor did not note any exceptions when tracing the vendor payment sample items to the checks. However, according to BHA's policy, two signatures are required on all checks, and the Executive Director was the only person signing checks. The external auditor told us he did not verify signatures on checks because most banks do not return checks or copies of checks with monthly bank statements. Instead, he told us that he relies on the banks for performing that control. We informed the external auditor that this was not the case at BHA where checks were returned with monthly bank statements. We also identified another audit document that showed the external auditor reviewed bank reconciliations and specifically noted his concern that the Executive Director was not only performing all of the steps in the disbursement process, but she was also performing bank reconciliations. One of the payroll disbursements the external auditor tested was a paycheck signed only by the

Executive Director and issued to the Executive Director; which we believe should have elevated the auditor's concern regarding potential irregularities. There was no record in the audit documentation that indicated that the auditor modified his approach for these circumstances.

Further, in a fiscal year 2008 internal control test to determine that the amounts paid employees were in agreement with the approved budget, the external auditor documented his conclusion that employees were being paid appropriately in accordance with the approved budget. However, his test showed that the Executive Director's actual salary payments were \$2,645 more than the annual budget for her salary and the maintenance employee's actual salary payments were \$1,200 more than the annual budget for his salary. In the audit documentation that we reviewed, the external auditor noted these discrepancies and stated that due to the insignificant amounts and the possibility of an extra pay period in the year, he chose not to further pursue these discrepancies.

---

**BHA's Former Board Failed to Ensure Its Financial Policies were Implemented, but the New Board Has Taken Steps to Improve Its Oversight**

BHA's former board did not properly oversee and manage the affairs of BHA to ensure compliance with the board's own policies concerning financial management. For example, the board failed to enforce its own resolution requiring 2 signatures on all non-payroll checks, making it easier for the Executive Director to make improper purchases and payments. All of the BHA board members in place during the time the alleged embezzlement took place have resigned and been replaced.

Members of BHA's new board with whom we spoke told us they are taking actions to enhance the board's oversight activities. For example, the new board has revised BHA's by-laws, designed and implemented additional internal controls, and produced a new employee handbook with an emphasis on a proper code of conduct for housing authority employees. The new board has also approved internal control enhancements to tenant accounts receivable, bank reconciliations, credit card statement review and approval processes, travel reimbursement, and check and bank drafts approvals. Our review of 2010 board minutes found the current board appears to be routinely conducting fiduciary oversight as part of its regular board meetings.

While these actions can help safeguard BHA's use of federal funds, the board faces ongoing challenges including recruiting and hiring a well qualified executive director. Because of BHA's poor financial condition, the interim executive director told us that he has agreed to stay in the

position without compensation until a new director can be hired.<sup>28</sup> The Board Chairman told us that the former executive director was bonded for \$50,000 and, pending an indictment or conviction, the board will receive the proceeds by this fall, which will enable it to hire a new executive director.

---

**HUD Received Additional Funds to Monitor Recovery Act Funds; On-Site Reviews Conducted at BHA in Successive Years**

HUD's Greensboro field office is responsible for oversight and monitoring of North Carolina's PHAs to ensure that federal funds are being used for their intended purpose. HUD's field office officials told us their office focuses its monitoring activities on about 15 high risk PHAs in North Carolina identified by the annual risk analysis. They also told us the office does not have sufficient resources, including staff, to conduct on-site monitoring of all PHAs in North Carolina. However, HUD field office officials told us the office received additional travel funds for oversight and monitoring of Recovery Act public housing funds. The field office director told us his office conducted remote reviews of all Recovery Act funds and visits to 21 public housing agencies receiving Recovery Act funds.<sup>29</sup> He also stated that while his office received additional travel funds for monitoring and oversight during the early days of the Recovery Act, the Greensboro office has requested still more funds for monitoring and oversight of Recovery Act funds. HUD officials reported that they conducted one on-site review of BHA in 2006, one on-site review and one remote review in 2007, and an asset management on-site review in 2009. According to these same officials, they also have conducted an on-site review at BHA in 2010.

---

<sup>28</sup>The interim executive director is a board member and he is not interested in the permanent executive director position.

<sup>29</sup>Remote reviews include examination of contracts when 25 percent of grants have been drawn down, procurement policies and amendments, grant initiations, annual financial statements, and work items included in the 5 year plan.

---

## North Carolina Continues to Rely on Recovery Act Funding in the Face of Budget Challenges, But Sees Signs of Economic Recovery

As of August 24, 2010, North Carolina had received \$6.9 billion in Recovery Act funding. State budget officials said that the Recovery Act funds directly affected North Carolina's fiscal stability. In addition to uses of the funds we detailed in previous reports, the state will use \$13 million from the Recovery Act's Workforce Initiative grant towards its JobsNOW 12 in 6 Program, which allows the Community College System to create at least 12 occupational training opportunities for state residents that can be completed in 6 months or less. The state's Workforce Development Boards will also use \$56 million from the Recovery Act's Workforce Initiative grant to set up programs across the state to provide job training support for adults, disadvantaged youth, and dislocated workers. The officials also told us the state will spend \$24 million from the State Veterans Home Construction Grant Program toward the construction of two Veteran nursing homes in the state.

On June 30, the North Carolina General Assembly passed and the state's governor signed the 2011 fiscal year budget; the first time in 7 years that the state has passed its budget on time. Overall, the newly enacted budget reduces state spending by 3.3 percent more than the legislature projected last year when it approved a 2 year budget for the 2009-2011 budget period.<sup>30</sup> While state officials tell us there are signs the state is working its way out of its economic downturn, state officials still took steps to constrain costs. For example, under the 2011 budget, state employees will not receive a raise for the second consecutive year.

State budget officials also told us the enacted budget assumed that approximately \$519 million in Federal Medical Assistance Percentages (FMAP) funds will be available, but the state will receive less than officials anticipated when they developed the state's budget. Specifically, in June, the Governor requested that the state legislature prepare a contingency budget in the event the increased FMAP was not continued. The suggested adjustments to address the end of the increased Recovery Act FMAP funds are outlined in Table 1. However, in August 2010, Congress passed and the President signed a 6 month extension of increased FMAP

---

<sup>30</sup>North Carolina's legislature operates on a bi-annual budgeting calendar. At the conclusion of the first year of funding for the two-year period, legislators review and revise planned spending for the upcoming year of the budget cycle.

funding for states<sup>31</sup>. According to the budget officials, the state will receive an estimated \$320.3 million in FMAP funds. A senior budget official said the only adjustment the state has made, as of September 1, is that the state will not hold retirement contributions but will have them sent to the state agencies' retirement systems. The state's budget director noted that given the current level of economic uncertainty and knowing North Carolina faces continued budget challenges in fiscal year 2011-2012, the state budget office is still requiring all agencies to establish an internal one percent Management Flexibility Reduction budget reserve as outlined in a July 2010 statewide memorandum.

**Table 1: Suggested Budgetary Adjustments to Address Potential Loss of Increased FMAP Funds, in priority order**

Suggested budgetary adjustments	Dollars in Millions
Transfer from the disaster relief reserve <sup>a</sup>	\$30
Transfer for unclaimed lottery prize money and excess receipts <sup>b</sup>	35
Use of interest from all other funds <sup>c</sup>	50
Use of balance in general fund availability <sup>d</sup>	23
Reduction of Medicaid provider rates <sup>e</sup>	27
Use of Funds from the savings reserve funds <sup>f</sup>	38
Reduction in retirement system contribution <sup>g</sup>	139
One percent (1%) management flexibility reduction <sup>h</sup>	178
<b>Total</b>	<b>\$519</b>

Source: GAO analysis of data provided by NC state budget officials.

Note: Total does not add due to rounding.

<sup>a</sup>The Disaster Relief Reserve is a budgetary reserve established by the North Carolina General Assembly to provide necessary and appropriate relief and assistance from the effects of natural disasters.

<sup>b</sup>The unclaimed lottery prizes are unclaimed prize revenues that would otherwise have been used by the Education Lottery Commission to enhance lottery prizes. Excess lottery receipts are lottery revenues collected in June 2010 that would otherwise have been transferred into the Education Lottery Fund to support specified Education programs.

<sup>c</sup>Interest from all other funds is interest earned from all non-General Fund governmental and proprietary funds.

<sup>d</sup>Balance of General Fund availability is the 2010--2011 available General Fund revenue that remains unappropriated by the 2010 NC General Assembly.

<sup>31</sup> The Recovery Act initially provided eligible states with an increased FMAP for 27 months from October 1, 2008, to December 31, 2010. Recovery Act, div. B, title V, § 5001, Pub. L. No. 111-5, 123 Stat. at 496. On August 10, 2010 federal legislation was enacted amending the Recovery Act and providing for an extension of increased FMAP funding through June 30, 2011, but at a lower level. *See* Pub. L. No. 111-226, § 201, 124 Stat. 2389 (Aug. 10, 2010).

---

<sup>e</sup>The Secretary of the NC Department of Health and Human Services shall reduce reimbursement rates paid to service providers in the Medicaid program (with certain exceptions as specified by the NC General Assembly).

<sup>f</sup>The Savings Reserve Fund of the “Rainy Day Fund” is a statutory reserve fund to address unanticipated events and circumstances in case of emergencies. Although this fund has been used to address the recent economic downturn, there is a balance remaining in this Fund.

<sup>g</sup>The state retirement system employer contribution rate (%of covered salaries) was reduced from 10.51% to 9.15% for the 2010-2011 fiscal year.

<sup>h</sup>A one percent annualized flexibility reduction is authorized as cuts made at the discretion of the agency head with the understanding that the agencies are encouraged to implement all administrative and other operating deficiencies, including the reduction of vacant positions which do not affect public safety or staffing ratios at State institutions, prior to the dismissal of employees.

Although North Carolina continued to experience significant fiscal challenges during the fiscal year ended June 30, 2010, senior budget officials told us the state avoided tapping into its “rainy day” funds. These officials also told us they are seeing gradual increases in property tax revenues. As state budget officials begin work on the state’s 2011-2013 bi-annual budget, they have projected a \$3 billion budget shortfall that will likely have to be addressed through further budget cuts or revenue enhancements.

---

## Recovery Act Funds Benefited Wilmington, but Did Not Prevent Budget Cuts to Some Programs and Services

Wilmington officials reported they received Recovery Act awards totaling over \$8.1 million for public safety, human services, energy, and transportation programs and activities. Wilmington applied for and received nearly \$2.3 million, or 28 percent, of its Recovery Act funds through the competitive grants process. Various federal agencies awarded the remaining funds through their formula grants process. Located in southeastern coastal North Carolina, Wilmington is the state’s eighth largest city with an estimated 101,350 residents, an increase of approximately 33 percent since 2000. Wilmington’s total operating budget for fiscal year 2011 is about \$140 million and its June 2010 unemployment rate was 8.6 percent, which is below the statewide level of 10.1 percent.

According to Wilmington officials, the combination of the city’s commitment to maintain core, critical public safety services, the required increases in expenditures, and the projected reductions in revenue necessitated a 0.0375 cents per \$100 valuation in its property tax, effective July 1, 2010, in order to balance its budget. Further, in addition to initiating some cutbacks in programs and services, the city also used about \$320,000 of its fund balance to help balance its budget. Wilmington officials chose not to initiate layoffs but froze all hiring, including not staffing 60 vacant positions. According to Wilmington officials, the hiring freeze was still in effect in June 2010 and future hiring will be done on a case-by-case basis.

Wilmington officials told us that the Recovery Act funds relieved some budgetary reductions and most likely helped avert layoffs. However, the officials noted that the additional administrative, accountability, and reporting responsibilities required by the Recovery Act significantly stretched staff capacity.

---

### Wilmington Used Recovery Funds to Support a Variety of New and Existing Priorities

The City of Wilmington received competitive and formula grants to help fund various priorities. For example, the COPS Hiring Recovery Program<sup>32</sup> enabled the city to hire 13 police officers who focus on community policing activities. Since receipt of these funds, 10 of the 13 officers have completed their necessary field training and are now serving in communities across Wilmington. Using additional Community Development Block Grant<sup>33</sup> funding under the Recovery Act, Wilmington officials committed funds to renovate a former jail for use as transitional housing for homeless ex-offenders re-entering the community. The project is scheduled to start construction in September 2010. The city plans to use its \$1.2 million Energy Efficiency and Conservation Block Grant<sup>34</sup> from the U.S. Department of Energy (DOE) to develop and carry out various strategic energy studies with the goal of identifying feasible and cost effective improvement measures. Wilmington successfully competed for additional Recovery Act funds through DOE's Local Energy Assurance

---

<sup>32</sup>The COPS Hiring Recovery Program (CHRP) is a competitive grant program designed to address the full-time sworn officer needs of state, local, and tribal law enforcement agencies nationwide. CHRP provides funding directly to law enforcement agencies to hire new and/or rehire career law enforcement officers in an effort to create and preserve jobs and to increase their community policing capacity and crime prevention efforts.

<sup>33</sup>The Community Development Block Grant (CDBG) program enables local governments to undertake a wide range of activities intended to create suitable living environments, provide decent affordable housing and create economic opportunities, primarily for persons of low and moderate income.

<sup>34</sup>The Recovery Act's Energy Efficiency and Conservation Block Grant (EECBG) Program seeks to deploy the cheapest, cleanest, and most reliable energy technologies across the country. It is intended to assist U.S. cities, counties, states, territories, and Indian tribes to develop, promote, implement, and manage energy efficiency and conservation projects and programs designed to, among other efforts, reduce fossil fuel emissions and improve energy efficiency in the transportation, building, and other appropriate sectors.

Planning grant (LEAP)<sup>35</sup> and will receive \$200,000 to hire a Sustainability Manager for the city. Along with managing the city's energy assurance activities, the Sustainability Manager will complete a comprehensive planning exercise to sustain a permanent capacity for emergency energy planning. The Sustainability Manager will also lead the city's energy demand reduction efforts by seeking a number of innovations to minimize the city's dependence on oil. In addition, under the Edward Byrne Memorial Justice Assistance Grant (JAG) program<sup>36</sup> the city entered into a partnership with the New Hanover County Sheriffs Department and used the funds to obtain needed public safety resources and equipment such as law enforcement vehicles, crime lab supplies, and tasers. City officials also plan to use nearly half of its \$8.1 million Recovery Act funding on a bike and pedestrian trail called the Cross City Trail. The asphalt trail will be a 20-mile off-road, multi-use path linking key city resources and providing access to shopping, recreational, cultural, and educational destinations. The officials noted that the Cross City Trail supports their initiatives to provide alternative modes of transportation and continue to become a more environmentally sustainable community. According to city officials, the \$4 million funding from the Recovery Act will enable the city to have the trail 75 percent complete by 2011 versus the anticipated completion date of 2030.

---

### City Officials Developed Plans for End of Recovery Act Funding

According to city officials, Wilmington will use the majority of its Recovery Act funds for one-time capital and construction related expenditures. The officials told us that each program or category of Recovery Act funding received by the city requires specific plans for the eventual elimination of available Recovery Act funding. The officials said that the plans clearly reflect program managers' understanding that all

---

<sup>35</sup>LEAP aims to facilitate recovery from disruptions to the energy supply and enhance reliability and quicker repairs following power outages. This initiative also aims to create jobs at the local level and allow cities to have well-developed, standardized energy assurance and resiliency plans that they can rely on during energy emergencies and supply disruptions. City governments will address energy supply disruptions risks and vulnerabilities in their plans to lessen the devastating impact that such incidents have on their economy and the health and safety of citizens.

<sup>36</sup>The JAG program, administered by the Bureau of Justice Assistance (BJA), is the leading source of federal justice funding to state and local jurisdictions. The JAG program provides states, tribes, and local governments with funding to support a range of program areas, including law enforcement, prosecution and court, prevention and education, corrections, community corrections, drug treatment and enforcement, planning, evaluation, and technology improvement, and crime victim and witness initiatives.

---

Recovery Act funded programs and services are temporary or “nonrecurring” expenditures. For example, Wilmington’s Police Department hired 13 officers under the COPS Hiring Recovery Program. The department plans to assimilate the newly hired officers onto the force as openings occur through attrition. The officials also told us that the Cross-City Trail will be maintained by the city through general funds.

---

## Reporting and Accountability: North Carolina Recovery Act Accountability Community

North Carolina has several entities that provide oversight to ensure the state’s recipients are held accountable for the Recovery Act funds they receive. These entities include the Office of the State Auditor (OSA), Office of Economic Recovery and Investment (OERI), the Office of Internal Audit (OIA), within the North Carolina Office of State Budget and Management (OSBM), as well as local government oversight authorities. As we reported in our May 2010 report, the state’s primary tool for ensuring accountability and oversight of federal funds is the “Single Audit,” which reports on internal controls over financial reporting and compliance with pertinent laws and regulations, as well as compliance with requirements applicable to each major federal program and internal controls over compliance in accordance with OMB circular A-133. In addition to the Single Audit, North Carolina’s oversight entities conduct a range of work related to ensuring recipients’ compliance with applicable laws and regulations. For this report, we interviewed senior administrators with OSA, OERI, and OIA to obtain updates on their work, since our last report, in monitoring the use of Recovery Act funds around the state.

---

## Office of the State Auditor

We previously reported that in addition to its work in conducting the Single Audit, OSA performs interim agency-specific internal control and compliance audits for agencies receiving Recovery Act funds. The state auditor’s office told us that its single audit reports have consistently reported findings related to subrecipient monitoring by state agencies. OSA’s recent interim agency audits have also included findings related to subrecipient reporting. For example, as of July 2010 OSA completed an audit of the North Carolina Department of Environment and Natural Resources (DENR) and found that the department did not consistently perform effective monitoring procedures to ensure that subrecipients of Recovery funds were in compliance with requirements of the Davis-Bacon

---

Act.<sup>37</sup> OSA also conducted an interim review of the North Carolina Department of Crime Control and Public Safety's internal controls over two programs—Edward Byrne Memorial Justice Assistance Program and the National Guard Military Construction program—receiving Recovery Act funds.<sup>38</sup> OSA found deficiencies in the state's subrecipient monitoring of the Edward Byrne Memorial Justice Assistance Program. Specifically, grant managers did not maintain complete records of monitoring visits and the checklists used as a monitoring tool did not address all federal compliance requirements.

OSA officials reported that in addition to reviews of specific agencies they are also beginning to review the efficiency of statewide systems, particularly those used for purchasing and contracting, which may also impact Recovery Act programs. For example, the OSA is reviewing contract monitoring policies and procedures to improve the efficiency and effectiveness of the state's contracting process and to ensure proper oversight of state contracts. Due in part to a series of contract audits conducted by OSA, the North Carolina General Assembly recently enacted legislation to improve oversight of state contracts.

---

Office of Economic  
Recovery and Investment

As we have previously reported, OERI was set up by the state to help agencies track, monitor, and report on Recovery Act funds. In May 2010, we reported that OERI officials told us that the implementation of a new software system that was intended to integrate North Carolina's various state agency systems containing Recovery Act funding information into an overall statewide system had experienced delays. This system was supposed to start operating by December 2009; instead OeRION, an

---

<sup>37</sup>OSA's review included an audit of three local governments. In the city of Conover, OSA found no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. In Pitt County, OSA found that the county did not collect certified payrolls from all subcontractors, as required by the Davis-Bacon provision of the Recovery Act, nor did they verify the job classification and pay rate of an interviewed employee. Finally, in the town of Kure Beach, OSA found that the town did not conduct interviews of employees from each contract and subcontract performed or collect certified payrolls from all subcontractors as required by the Davis-Bacon provision of the Recovery Act.

<sup>38</sup>State of North Carolina Office of the State Auditor. *Department of Crime Control and Public Safety: Results of Audit Procedures Applied to the Design of Internal Control over Compliance for Selected Programs Awarded American Recovery and Reinvestment Funds for the Years ended June 30, 2009 and June 30, 2010* (North Carolina: Office of the State Auditor), 4.

acronym for Office of Economic Recovery and Investment Oversight for North Carolina, was implemented in June 2010. As of May 2010, \$146,004 of Recovery Act funds had been used for licensing and short term staffing to develop the application. An OERI official reported to us that although the OeRION system went “live” in June 2010, the office would not be able to track the weekly status of the state’s Recovery Act funds, as anticipated.<sup>39</sup> Rather, this official reported, OeRION will be primarily used for maintenance of OERI’s record of all Recovery Act awards in the state and any corresponding reports.

In addition to tracking the use of funds, an OERI official reported to us that the office is also working with state agencies in developing and implementing their corrective action plans to resolve OSA findings related to Recovery Act funds. For example, OERI issued a report to the Office of the Governor outlining steps the North Carolina Department of Health and Human Services (NCHHS) would make in addressing findings in a January 2010 report, written by OSA, related to providing timely information to subrecipients, cash management procedures, and subrecipient monitoring.<sup>40</sup> OERI officials reported that the office has conducted similar efforts regarding OSA findings in January 2010 reports on the Department of Commerce, which administers the Workforce Investment Act of 1998 (WIA) and State Energy Programs and DENR, which administers the Clean Water State Revolving Fund and Drinking Water State Revolving Fund Recovery Act programs. OERI officials also reported that the office will continue to meet with the agencies with OSA findings on their Recovery Act programs to monitor the impact of the changes made through the corrective action plans.

As we reported in our May 2010 report, OERI issued a directive for all recipients and subrecipients regarding the use of Recovery Act funds for procurements of goods and services.<sup>41</sup> In April 2010, OERI issued another management directive directing North Carolina’s state agencies to ensure

---

<sup>39</sup>As we reported in our May 2010 report, this weekly report is known as the *Weekly Funding and Disbursement Report* and it is prepared using the weekly reports of state agencies.

<sup>40</sup>This report included 12 programs receiving Recovery Act funds, including Medicaid and Community Services Block Grant.

<sup>41</sup>OERI Management Directives 3 and 3(b) (May 2009 and January 2010) “Contract Provisions for the Procurement of Goods, Services, and Construction Projects Including Design Services and Internal Procurement Directives.”

compliance with Recovery Act procurement requirements and OERI's May 2009 directives. Based on our discussion with officials, this management directive required state agencies to design an audit program for Recovery Act projects and contracts that includes regularly scheduled on-site visits and desk reviews. OERI's directive also required an initial report on April 30, 2010, of state agencies' plans, and a report every 30 days thereafter certifying that subrecipients used a competitive process for Recovery Act purchases or reported if an exception was used along with a statement of justification.<sup>42</sup> OERI also scheduled several technical assistance seminars around the state to provide guidance on complying with its directives. Since our May 2010 report, a senior OERI official reported to us that the office has continued to conduct technical assistance sessions around the state as well as make presentations for administrators of Recovery Act funds during state conferences. In addition, OERI provides a range of resources such as webinars and checklists on its website to help agencies comply with Recovery Act requirements and its directives related to procurement. This official also reported that state agencies are submitting the required monthly reports regarding progress in ensuring compliance and, as a result, OERI has seen a more planned approach among the state's agencies in this area.

---

## Office of Internal Audit

OIA provides internal audit services for eight of North Carolina's state agencies.<sup>43</sup> In addition, OIA is using some of the Recovery Act funds allocated to OSBM to provide additional monitoring assistance to North Carolina agencies. In September 2009, OIA received \$1.2 million from the Recovery Act State Fiscal Stabilization Fund (SFSF) for the purposes of monitoring. These monitoring efforts include funds to hire four additional auditors to cover the workload associated with the risk assessments, compliance reviews, and assessments of sub-recipient monitoring plans for Recovery Act funds. In addition, the North Carolina State Energy Office provided funds for one auditor through a memorandum of agreement.

---

<sup>42</sup>OERI Management Directive 8, "ARRA Compliance and Competition Management" (April 2010).

<sup>43</sup>These agencies are, the Department of Administration; (2) North Carolina Department of Commerce (NCDOC); (3) OSA; (4) Department of Labor; (5) Community Colleges Central Office; (6) OSBM; (7) Governor's Office; and (8) Wildlife Resource Commission. According to OIA's Assistant State Budget Officer/Audit Director, other state agencies have their own Internal Audit office.

Since our last report, OIA has issued one compliance review and three risk assessments related to Recovery Act funds. In June 2010, the office issued its findings related to its compliance review of agencies' use of the SFSF funds.<sup>44</sup> OIA found that one local educational agency (LEA) and one charter school were out of compliance with OERI's management directives for procurement. In addition, the office recommended that OSBM and the two agencies overseeing the state's institutes of higher education ensure that information on the Recovery Act whistleblower protections and U.S. Office of Management and Budget (OMB) guidance on referrals to inspectors general are properly communicated to the relevant parties.<sup>45</sup> As of July 2010, OIA had issued agency-specific risk assessments for Recovery Act programs administered by the Department of Public Instruction (DPI), DENR, and NCHHS. The risk assessments are a part of OIA's effort to identify those Recovery Act programs that may require more attention from OIA auditors.<sup>46</sup> Based on discussions with relevant program and audit staff and prior audit findings, OIA assessed risks for 7 DPI programs, 11 DENR programs, and 35 NCHHS programs receiving Recovery Act funds.

Although OIA has continued to conduct audits and risk assessments of Recovery Act programs, OIA's Assistant State Budget Officer stated that there have been challenges to the office's ability to carry out its auditing responsibilities since our last report. Specifically, OIA officials told us, the office has lost 2 of the 5 auditors it hired to assist with its planned monitoring. Three agencies—NCHHS, DPI, and DENR—were each assigned one of 5 newly hired auditors. The fourth auditor was responsible for conducting audits of the remaining State agencies receiving Recovery Act funds. The fifth auditor, hired to perform audits on the State Energy Program and Weatherization Assistance Program, resigned in March 2010, as we reported in our May 2010 report. An OIA official said that the auditor

---

<sup>44</sup>According to OIA's report, the purpose of the audit was to determine if the agency's SFSF transactions (both fiscal and performance) comply with applicable state and federal laws, rules, and regulations in the areas of (1) funding expenditures (2) cash management, and (3) data quality and performance reporting. The report covered the time period of May 2009 through January 2010 for the North Carolina Department of Public Instruction and May 2009 through December 2009 for all other agencies.

<sup>45</sup>State of North Carolina Office of Internal Audit. *Memorandum: ARRA-State Fiscal Stabilization Fund Compliance (North Carolina: Office of the Internal Audit)*, 1. For the whistleblower protections in the Recovery Act, see Recovery Act, div. A, §1553.

<sup>46</sup>According to an OSBM official, OIA conducted a prior risk assessment to determine in which agencies its auditors would be placed.

that was assigned to DPI resigned 2 months after being hired. OIA transferred the auditor assigned to DENR to the Department of Commerce. These changes left OIA with 3 auditors to conduct its monitoring work. An OIA official reported that the office permanently lost the auditing position it acquired through an agreement with the North Carolina State Energy Office because administrators decided to use the funds for that position in a different manner. This OIA official said that the office is in the process of hiring an auditor for DPI, using Recovery Act funds, and will use two positions funded by the North Carolina Department of Administration to monitor state agencies' compliance with procurement rules and regulations.

---

### Office of Auditor General's Single Audits Provide Oversight of Some Recovery Act Funds

According to data from the Federal Audit Clearinghouse, which is responsible for receiving and distributing single audit results, it received North Carolina's Single Audit reporting package for the year ending June 30, 2009, on March 30, 2010. This was the first Single Audit for North Carolina that includes Recovery Act programs, and it included only 4 months of Recovery Act expenditures. North Carolina's Single Audit report for fiscal year 2009 identified 160 significant internal control deficiencies related to compliance with federal program requirements, of which 36 were classified as material weaknesses. Some of these material weaknesses and significant deficiencies occurred in programs that included Recovery Act funds.

---

### Agency Comments on This Summary

We provided a draft of all materials related to Head Start and Early Head Start to OHS and HHS for comment, but they did not provide comments in time for us to consider them in the report. We also verified factual information with the local Head Start expansion programs we visited. In addition, we provided a draft copy of this appendix to the North Carolina Office of Economic Recovery and Investment, the North Carolina State Auditor's Office, the North Carolina Office of State Budget and Management, and other relevant state offices for review and comment. We also provided excerpts of the draft to other entities covered in this appendix for review and comment. Officials of the Office of Economic Recovery and Investment, State Auditor's Office, and the Office of Internal Audit within the Office of State Budget and Management provided clarifying and technical comments which we incorporated into the report as appropriate. In addition, several other entities provided clarifying and technical comments, which we have also incorporated as appropriate.

---

**GAO Contacts**

Cornelia M. Ashby, (202) 512-8403 or [AshbyC@gao.gov](mailto:AshbyC@gao.gov)

Paula M. Rascona, (202) 512-9816, or [RasconaP@gao.gov](mailto:RasconaP@gao.gov)

---

**Staff  
Acknowledgments**

In addition to the contacts named above, Laura Acosta, Sandra Baxter, Sarah Jane Brady, Bonnie Derby, Bryon Gordon, Sara S. Kelly, Tahra Nichols, Anthony Patterson, Connie Sawyer, and Sandra Silzer made major contributions to this report.

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.