

**Office of the State Auditor**

**Beth A. Wood, CPA**  
State Auditor

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October 13, 2014

The Honorable Pat McCrory, Governor  
The Honorable Thom Tillis, Speaker of the House  
The Honorable Phil Berger, President Pro Tempore  
The Honorable Julia Howard, Co-Chair Program Evaluation Oversight Committee  
The Honorable Fletcher Hartsell, Co-Chair Program Evaluation Oversight Committee  
Mr. Patrick Woodie, Acting President, NC Rural Economic Development Center, Inc.

This letter and attached findings present the results of our financial related audit of the NC Rural Economic Development Center, Inc.

The objective of this audit was to answer the questions, as listed in this report, asked by legislators about the NC Rural Economic Development Center, Inc.'s, transfer of state funds to the State. The audit scope included the period July 1, 2007, to October 31, 2013.

Acting President Patrick Woodie reviewed a draft copy of this report. His written comments are included in the Appendix.

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

To accomplish our audit objective, we gained an understanding of internal control over matters described above and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and operations.

We wish to express our appreciation to the staff of the NC Rural Economic Development Center, Inc., for the courtesy, cooperation, and assistance provided us during the audit.

If you have any questions, please do not hesitate to contact my office.

Sincerely,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

## BACKGROUND

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On July 18, 2013, the State Budget Director authorized a “freeze order” of state funds to and by the Rural Center. He also notified the Rural Center that the Office of State Budget and Management was considering further action to recover **State funds** in the Rural Center’s possession and directing the transfer of said funds to the State Treasurer.

On October 30, 2013, the Department of Commerce (Commerce) and the Rural Center signed a grant contract amendment<sup>1</sup> stating the Rural Center would transfer to Commerce and/or the State General Fund:

- All obligated funds for outstanding grants;
- All unobligated or available funds, including any funds that have been designated to be used for administrative purposes;
- Fifty percent (50%) of the interest currently held by the Rural Center that was earned from state appropriations related to the Clean Water Partners program.

The Joint Legislative Program Evaluation Oversight Committee requested answers to the following questions:

1. Are there any additional state funds remaining at the Rural Center? **Finding #1**
2. How accurate was the Rural Center’s report that it currently held approximately \$11.6 million in interest earnings? **Finding #2**
3. How much of the \$3 million the Rural Center reported as interest earnings from fund sources other than the Clean Water Partners was derived from state funds? **Finding #3**
4. Did the Rural Center have a full compliance audit performed on state grant funds? **Finding #4**

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<sup>1</sup> All state appropriated grant funds approved by the General Assembly were awarded to the Rural Center via a grant contract agreement. Therefore, any reversion of funds noted in the October 30, 2013, contract amendment only apply to state appropriated grant funds the Rural Center received under such prior grant contract agreements. Other state funding, such as Federal pass-through funds like the SBCI funds, were not included in the contract amendment.

## FINDINGS

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### 1. Are there any additional state funds remaining at the Rural Center?

The NC Rural Economic Development Center (Rural Center) does not hold any additional state appropriated grant funds.

The Rural Center transferred all state appropriated grant funds it held as of October 31, 2013, back to the State, as agreed to in the grant contract amendment between the Rural Center and the Department of Commerce dated October 31, 2013.

The state appropriated grant funds that were transferred consisted of:

Obligated grant funds	\$69,218,741
Unobligated grant funds	25,231,473
Unobligated administrative funds	1,428,530
50% of CWP interest (See Question #2)	<u>4,328,971</u>
Total amount transferred	\$100,207,715

However, the Rural Center retained approximately \$22.3 million in federal pass-through funds that are, by statutory definition, state funds. See **MATTER FOR FURTHER CONSIDERATION** for additional discussion.

### 2. How accurate was the Rural Center's report that it held approximately \$11.6 million in interest earnings as of October 31, 2013?

Auditors were not able to verify that the Rural Center held approximately \$11.6 million in interest earnings as of October 31, 2013, because the Rural Center comingled interest earnings with non-interest earnings such as administrative receipts and donations.

Although NC statute<sup>2</sup> provides guidance to local governments on how interest earned on state appropriations should be treated, no such guidance existed prior to July 1, 2014,<sup>3</sup> for any of the non-profit entities that received state appropriations.

The Rural Center kept detailed accounting records on the use of interest earned on funds from the Clean Water Partners (CWP) program.

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<sup>2</sup> "Local Government Finance Act" *NCGS §159-30(e)* "Interest earned on deposits and investments shall be credited to the fund whose cash is deposited or invested. Cash of several funds may be combined for deposit or investment if not otherwise prohibited by law; and when such joint deposits or investments are made, interest earned shall be prorated and credited to the various funds on the basis of the amounts thereof invested, figured according to an average periodic balance or some other sound accounting principle. Interest earned on the deposit or investment of bond funds shall be deemed a part of the bond proceeds" (emphasis added).

<sup>3</sup> *NCGS §143C-6-23(d)(5)* Directs the Office of State Budget and Management to adopt rules to establish policies and procedures that "Provide for adequate oversight and monitoring to prevent the misuse of grant funds. These policies shall require each grantee and subgrantee to ensure that, for accounting purposes, State funds and interest earned on those funds remain separate and apart from other funds in the possession or control of the grantee or subgrantee" (emphasis added). *NCGS §143C-6-23(j)* "Except as otherwise required by federal law or the terms of a federal grant, interest earned on grant funds after receipt of the funds by a grantee or subgrantee shall be credited to the grantee or subgrantee and shall be used for the same purposes for which the grant or subgrant was made" (emphasis added).

## FINDINGS

Therefore, auditors were able to verify that the Rural Center earned \$11.3 million and spent \$2.7 million of interest from the CWP program by reviewing detailed accounting records, audited financial statements, and monthly bank statements for 2008 through 2013. From the same records, auditors were able to verify that the Rural Center held \$8.6 million in interest earnings from the CWP program as of October 31, 2013. (See Table 1 below)

However, the Rural Center did not keep detailed accounting records on the use of interest earned on non-CWP funds.

By using audited financial statements and bank statements, auditors were able to verify that the Rural Center earned \$10 million of interest from non-CWP funds.

But due to a lack of detailed accounting records for interest earned on non-CWP funds, auditors could not verify that the Rural Center spent \$7 million or had a balance of \$3 million remaining from interest earned on non-CWP funds as of October 31, 2013.

As noted above, the Rural Center did not separately identify and track interest earned on non-CWP state appropriated grant funds. Instead, the Rural Center's accounting records indicated interest earnings from non-CWP fund sources were pooled into "other income" accounts with other sources of unrestricted revenue, losing its identity as interest earned on state appropriated grant funds.

Table 1 below shows that the Rural Center earned approximately \$21.3 million in interest from 2008 through 2013: \$11.3 million interest on funds from the CWP program and \$10.0 million of interest from non-CWP funds.

**Table 1 – Interest Earned and Spent From 2008 – 2013, Balance on 10/31/2013**

<b>Interest:</b>	<b>Earned</b>	<b>Spent</b>	<b>Balance</b>
From CWP Funds	\$11.3 million	\$2.7 million	\$8.6 million
From Non-CWP Funds	\$10.0 million	\$7.0 million**	\$3.0 million*
<b>TOTAL</b>	<b>\$21.3 million</b>	<b>\$9.7 million**</b>	<b>\$11.6 million**</b>

**Source:** Rural Center's audited financial statements, bank statements, and "NC Rural Economic Development Center: Overview of the Transition Plan."

\*This balance was reported by the Rural Center. However, auditors were not able to verify this balance.

\*\*These amounts were calculated based on the Rural Center's report that it held \$3.0 million at October 31, 2013. However, auditors were not able to verify these amounts.

Because auditors could not verify all of the amounts that make up the remaining interest balance, auditors could not verify that the \$11.6 million in interest earnings reported by the Rural Center as of October 31, 2013, was accurate.

## FINDINGS

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**3. How much of the \$3 million the Rural Center reported as interest earnings from fund sources other than the CWP was derived from state funds?<sup>4</sup>**

Auditors were not able to determine how much of the \$3 million the Rural Center reported as interest earnings from sources other than CWP funds were earned from state funds.<sup>4</sup>

Table 2 below shows that the Rural Center earned approximately \$10 million in interest on non-CWP funds from 2008 through 2013. Auditors were able to verify this amount from bank statements and audited financial statements.

**Table 2 – Interest Earned and Spent From 2008 – 2013, Balance on 10/31/2013**

<b>Interest:</b>	<b>Earned</b>	<b>Spent</b>	<b>Balance</b>
From CWP Funds	\$11.3 million	\$2.7 million	\$8.6 million
<b>From Non-CWP Funds</b>	\$10.0 million	\$7.0 million**	<b>\$3.0 million*</b>
<b>TOTAL</b>	\$21.3 million	\$9.7 million**	\$11.6 million**

**Source:** Rural Center’s audited financial statements, bank statements, and “NC Rural Economic Development Center: Overview of the Transition Plan.”

\*This balance was reported by the Rural Center. However, auditors were not able to verify this balance.

\*\*These amounts were calculated based on the Rural Center’s report of holding \$3.0 million at October 31, 2013. However, auditors were not able to verify these amounts.

However, the Rural Center did not keep detailed accounting records on the use of interest earned on non-CWP funds.

Instead, the Rural Center's accounting records indicated interest earnings from all non-CWP fund sources were pooled into “other income” accounts with other sources of unrestricted revenue, losing its identity as interest earned on state appropriated grant funds.

Consequently, auditors could not determine how much of the \$3 million that the Rural Center reported as being interest earnings from fund sources other than the CWP program was derived from state funds. In fact, auditors could not verify that the reported \$3 million balance is accurate.

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<sup>4</sup> The Rural Center reported approximately \$3 million in interest earnings remained from sources other than CWP program funds as of October 31, 2013.

## FINDINGS

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Although NC statute<sup>5</sup> requires local governments to establish and maintain an accounting system designed to show the details of all revenues and expenditures, no such requirement existed prior to July 1, 2014, for any of the non-profit entities that received state appropriations.<sup>6</sup>

Nevertheless, the Rural Center received approximately 97% of its funding from state appropriations until June 30, 2013. Therefore, substantially all of the interest earnings it held as of October 31, 2013, would have been earned from state appropriated grant funds.

#### 4. Did the Rural Center have a full compliance audit performed on state grant funds?

The Rural Center never had a compliance audit on state appropriated grant funds. Local governments that receive state appropriated grant funds are required to have audits performed to determine an organization's compliance with specific state program and grant requirements and are done on a program-by-program level, based on risk criteria adopted by the State.

Although NC statute<sup>7</sup> requires local governments to have a compliance audit conducted on state appropriations, no such requirement exists for any of the non-profit entities that receive state appropriations.

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<sup>5</sup> "Local Government Finance Act" *NCGS §159-26(a)* "Each local government or public authority shall establish and maintain an accounting system designed to show in detail its assets, liabilities, equities, revenues, and expenditures (emphasis added). The system shall also be designed to show appropriations and estimated revenues as established in the budget ordinance and each project ordinance as originally adopted and subsequently amended."

<sup>6</sup> *NCGS §143C-6-23(d)(5)* Directs the Office of State Budget and Management to adopt rules to establish policies and procedures that "Provide for adequate oversight and monitoring to prevent the misuse of grant funds. These policies shall require each grantee and subgrantee to ensure that, for accounting purposes, State funds and interest earned on those funds remain separate and apart from other funds in the possession or control of the grantee or subgrantee" (emphasis added). *NCGS §143C-6-23(j)* "Except as otherwise required by federal law or the terms of a federal grant, interest earned on grant funds after receipt of the funds by a grantee or subgrantee shall be credited to the grantee or subgrantee and shall be used for the same purposes for which the grant or subgrant was made" (emphasis added).

<sup>7</sup> *North Carolina General Statute 159-34* "Annual independent audit; rules and regulations - Each unit of local government and public authority shall have its accounts audited as soon as possible after the close of each fiscal year by a certified public accountant or by an accountant certified by the Commission as qualified to audit local government accounts. When specified by the secretary [of the Local Government Commission], the audit shall evaluate the performance of a unit of local government or public authority with regard to compliance with all applicable federal and State agency regulations" (emphasis added). The secretary requires a compliance audit when a local government spends \$500,000 or more of state appropriations in one year.

## MATTER FOR FURTHER CONSIDERTATION

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### **\$22 Million in Federal Pass-Through Funds Remain at the Rural Center**

As of October 31, 2013, the Rural Center retained approximately \$22 million in federal pass-through funds related to the Small Business Credit Initiative (SBCI) that are statutorily defined as state funds by NCGS §143C-6-22.

The SBCI funds are considered state funds according to statute because they were sent directly to the NC State Treasury from the US Treasury Department.

NCGS §143C-6-22 “Use of State Funds by non-State Entities” reads:

(a) Disbursement and use of State Funds – Every non-State entity that receives, uses or expends any State funds shall use or expend the funds only for the purposes for which they were appropriated by the General Assembly. **State funds include federal funds that flow through the State Treasury** (emphasis added).

### **Program Details**

The US Treasury Department allocated \$46.6 million to the NC Department of Commerce as part of the SBCI created by the Small Business Jobs Act of 2010 (Act). The purpose of the Act was to provide "critical resources to help small businesses continue to drive economic recovery and create jobs... while offering billions more in lending support, tax cuts, and other opportunities for entrepreneurs and small business owners."<sup>8</sup>

The Department of Commerce contracted with the Rural Center to administer three such state programs on its behalf:

- Capital Access Program - \$8,261,319
- Loan Participation Program - \$27,800,000
- Funds for Funds Program - \$10,000,000

The \$46.6 million in federal pass-through funds, and any interest earned on these funds, must be used specifically for the state’s SBCI programs. If the Department of Commerce were to cancel its contract agreement with the Rural Center to administer these SBCI programs, the State would be required to either:

- Create and administer the SBCI programs in-house within a state agency, approved by the US Treasury Department;
- Contract with another entity to administer the SBCI program, approved by the US Treasury Department; or
- Return to the US Treasury Department, at minimum, any remaining unexpended funds still held by the Rural Center.

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<sup>8</sup> [http://www.sba.gov/about-sba/sba\\_initiatives/small\\_business\\_jobs\\_act\\_of\\_2010](http://www.sba.gov/about-sba/sba_initiatives/small_business_jobs_act_of_2010)

APPENDIX

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October 3, 2014

The Honorable Beth A. Wood  
Office of the State Auditor  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601

Dear Ms. Wood:

Thank you for the opportunity to review the financial related audit of the N. C. Rural Economic Development Center, Inc. With regards to the four findings contained in the audit letter, the N. C. Rural Center is in agreement.

The center is aware of and supports state reform efforts as they relate to private non-profits who receive state funding. The Rural Center always sought to fully comply with all federal and state laws and regulations related to the funds we administered. We shall always strive to hold ourselves to the highest standards of fiscal accountability, and we will make every effort to fully comply with all applicable laws and regulations related to the funds we manage now and in the future.

We further wish to express our appreciation to the staff of the Office of the State Auditor with whom we have worked over the past few months. We appreciate the courtesy and consideration that has been extended to us.

North Carolina  
  
Rural Economic  
Development Center, Inc.  
  
4021 Cary Drive  
  
Raleigh, NC 27610  
  
Phone: (919) 250-4314  
  
FAX: (919) 250-4325

Sincerely,

A handwritten signature in cursive script that reads "Patrick N. Woodie".

Patrick N. Woodie  
President

## ORDERING INFORMATION

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Copies of this report may be obtained by contacting the:

Office of the State Auditor  
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For additional information contact:

Bill Holmes  
Director of External Affairs  
919-807-7513

This audit was conducted in 1,953 hours at a cost of \$183,582.