



# STATE OF NORTH CAROLINA

**FISCAL CONTROL AUDIT REPORT ON  
NORTH CAROLINA DEPARTMENT OF THE SECRETARY OF STATE  
RALEIGH, NORTH CAROLINA  
FOR THE PERIOD JULY 1, 2002 THROUGH JANUARY 31, 2003**

**OFFICE OF THE STATE AUDITOR**

**RALPH CAMPBELL, JR.**

**STATE AUDITOR**

**FISCAL CONTROL AUDIT REPORT ON**  
**NORTH CAROLINA DEPARTMENT OF THE SECRETARY OF STATE**  
**RALEIGH, NORTH CAROLINA**  
**FOR THE PERIOD JULY 1, 2002 THROUGH JANUARY 31, 2003**

**ELAINE F. MARSHALL**  
**SECRETARY OF STATE**



Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

## AUDITOR'S TRANSMITTAL

---

The Honorable Michael F. Easley, Governor  
The General Assembly of North Carolina  
The Honorable Elaine F. Marshall, Secretary of State  
North Carolina Department of the Secretary of State

This report presents the results of our fiscal control audit of the North Carolina Department of the Secretary of State for the period July 1, 2002 through January 31, 2003. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of the audit was to gather and evaluate evidence about selected internal control policies and procedures designed to ensure reliable financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions.

The results of our audit disclosed significant weaknesses in internal control and/or significant instances of noncompliance that are described in the Audit Findings and Recommendations section of this report.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in black ink that reads 'Ralph Campbell, Jr.'.

Ralph Campbell, Jr.  
State Auditor

# TABLE OF CONTENTS

---

	PAGE
BACKGROUND INFORMATION .....	1
OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS .....	3
AUDIT FINDINGS AND RECOMMENDATIONS.....	5
DISTRIBUTION OF AUDIT REPORT .....	9

## **BACKGROUND INFORMATION**

---

The Office of the Secretary of State (the Office) is a constitutionally established State agency. In general, the Office is charged with recording, registering, and storing all official documents of the State of North Carolina and certain records pertaining to private businesses. Additionally, the Office is required to compile and prepare for distribution official publications relative to the operations of the State and local governments. The main statutory authority for the Office is contained in Article 4 of Chapter 147 of the General Statutes.

[ This Page Left Blank Intentionally ]

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

---

## **OBJECTIVES**

As authorized by Article 5A of Chapter 147 of the *North General Statutes* and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at the North Carolina Department of the Secretary of State. The objective of the audit was to gather and evaluate evidence about selected internal control policies and procedures designed to ensure reliable financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions for the period July 1, 2002 through January 31, 2003.

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

## **SCOPE**

Our audit scope included selected internal controls in the following areas.

### General

*Control Environment* - The control environment consists of the actions, policies, and procedures that reflect the overall attitude of top management about control and its importance to the entity. The control environment sets the tone of the organization, influencing the control consciousness of its employees.

### Financial Accounting and Reporting

*Revenue Cycle* - An entity's revenue cycle generally consists of the activities associated with the receipt of cash and billing for amounts due from other parties. Financial statement accounts typically impacted by the cycle include cash, accounts receivable, fees, licenses, and fines.

### Finance-related Compliance

*Cash Management and Investments* - Laws and regulations commonly set limits on the number of days cash collections can be held prior to depositing them to the credit of the State Treasurer. For example, agencies are required to deposit moneys in approved depositories in accordance with the Daily Deposit Act.

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

---

### **METHODOLOGY**

To accomplish our audit objective, we gained an understanding of internal control, performed tests of control effectiveness, and performed corroborating direct tests of the accounting records, reports, and/or compliance as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Our procedures were more limited than would be necessary to give an opinion on internal control, and accordingly, we do not express such an opinion.

### **RESULTS**

The results of our audit disclosed significant weaknesses in internal control and/or significant instances of noncompliance or abuse that are described in the Audit Findings and Recommendations section of this report.

The purpose of this report is to provide management and oversight organizations recommendations needed to improve internal control over financial accounting and reporting and compliance with finance-related laws, regulations, and contract provisions. Consequently, reporting on accomplishments in areas that appear to be functioning properly is beyond the scope of this audit.



## **AUDIT FINDINGS AND RECOMMENDATIONS**

---

### **Matters Related to Financial Accounting, Reporting, or Compliance**

*Current Year Findings and Recommendations* - The following findings and recommendations were identified during the current audit and describe conditions that represent significant deficiencies in internal control over financial accounting and reporting or noncompliance with finance-related laws, regulations, and contract provisions.

#### 1. IMPROVE CONTROLS OVER THE COLLECTION AND PROCESSING OF CASH RECEIPTS

The Department of the Secretary of State does not have policies and procedures in place to ensure that all monies collected are deposited daily with the State Treasurer. We noted the following significant internal control weaknesses in the Department's various receipting processes:

- Not all monies received are deposited intact daily.
- No standard cash collection operating procedures are in place to capture and document funds received by the Department. Each division has separate and different procedures for collecting and processing receipts including closing out at various times of the day.
- Receipts issued for cash payments received are not adequately accounted for and used in the reconciliation of deposits made.
- None of the thirty-four receipts tested by us were deposited in accordance with State law. The receipts were deposited late, ranging from two to forty-seven days late. Examples of amounts involved and the days it took for their deposit follow:
  - \$22,432 was not deposited for 47 days
  - \$17,120 was not deposited for 38 days
  - \$51,910 was not deposited for 2 days

Adequate internal control requires that policies and procedures be in place to ensure that all collections are properly identified, daily collections control totals exist, and collections are promptly deposited intact in accordance with the Daily Deposit Act. The risk of misappropriation of cash increases when daily deposits are not made in this manner.

*Recommendation:* The Department should establish and implement written policies and procedures that require daily incoming receipts collected be reconciled to the amounts deposited. Further, the Department should strengthen procedures to ensure that receipts are deposited daily in accordance with the Daily Deposit Act.

## **AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)**

---

*Agency's Response:* The Department acknowledges the necessity of maintaining procedures that effectively ensure funds received are controlled and deposited daily. Efforts are underway to improve performance with respect to this requirement.

A Department-wide daily deposit cut-off time has been implemented. Department-wide procedures for collection and processing of cash receipts are being implemented. Further development of division specific procedures by each unit processing receipts and generating daily deposits is progressing. As each division manager refines these procedures consistent with Departmental cash management policy, their procedures will be filed with the Department's Budget Division. These procedures and the associated processes will be evaluated to verify their adequacy and any necessary improvements will be implemented.

Automated clearinghouse transactions that were processed by the Information Technology Division during the development and implementation stages of our electronic payment services are now processed and closed out daily by Budget Division staff. This change will ensure daily deposit of electronic payments and segregate duties in this area of the cash collection process.

Changes have been implemented for processing cash receipts in the Cash Management Section that will ensure monies collected in the Cash Management Section are deposited daily according to expectations. Additional changes have been implemented in the Corporations Division. The opening of mail, identification of receipts and preparation of deposits have been centralized in this division. Fewer employees handle receipts, and cash controls are improved. Additional process improvements are under consideration and will be implemented as resources allow.

### **2. IMPROVE SEGREGATION OF DUTIES IN THE CASH COLLECTION PROCESS**

We noted inadequate segregation of duties in the cash collection process:

- The individual who designed, maintains, and makes program changes to the Secretary of State Knowledge Base (SOSKB) system also processes automated clearinghouse transactions using that system.
- The individual who prepares the certification of deposit also posts accounts receivable.

Inadequate segregation of duties increases the risk that errors and irregularities may occur and not be detected. The Office of the State Controller requires all State agencies to design and implement internal control procedures that provide adequate segregation of duties. Adequate segregation of duties ensures that no one individual can authorize and record transactions, issue and receive assets, and reconcile assets to accounting records.

## AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

---

*Recommendation:* The Department should design and implement internal control procedures that provide adequate segregation of duties. Individuals who design or maintain key systems such as the Department's SOSKB system should not also process real transactions or have access to assets. Similarly, individuals who have access to cash should not also have the ability to make entries into the accounting records or subsidiary ledgers.

*Agency's Response:* The accounts receivable activities and the preparation of deposits are now performed by separate employees in the Budget Division. The Information Technology Division no longer closes out the ACH transactions.

Budget Division procedures have been developed to ensure appropriate segregation of duties. The IT Division will continue to design and make program changes to the software system which is used to automate the processing of these transactions. An accounting technician in the Budget Division closes the ACH file daily. These procedures have been included in the Department's Cash Management Plan and are included in Budget Division procedures for close-out of electronic transactions.

### 3. APPROVAL FOR A CHANGE TO THE CASH MANAGEMENT PLAN NOT OBTAINED

The Department failed to obtain approval from the Office of the State Controller for a significant change made to the Department's cash management plan. The Department started accepting Automated Clearing House (ACH) transactions in September 2001 and credit card payments in November 2002. In the most recently updated cash management plan, the Department stated that it did not receive electronic funds transfers.

The Office of the State Controller requires State agencies to obtain approval for any change to the agency's cash management plan. Failure to obtain proper approval for changes to an agency's cash management plan may result in the use of billing, collection and deposit procedures that do not maximize the interest-bearing investment of cash as required by the State cash management plan.

*Recommendation:* Management should submit all planned changes of the agency's cash management plan to the Office of the State Controller for approval.

*Agency's Response:* The Department hosted an initial information meeting in May 2001 with representatives from the State Treasurer's Office and the Office of the State Controller to discuss our intent to accept electronic payments. Standard Operating Procedures were developed, approved and implemented. Bank and merchant accounts were established by the Treasurer's Office and OSC. Our processes were evaluated and refined as needed during late 2001 early 2002 to ensure satisfactory operation of the system. The Department started accepting Automated Clearing House transactions in September 2001 and credit card payments in November 2002.

## **AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)**

---

Changes implementing the acceptance of ACH transactions and credit card payments were made with the support and consent of State Information Technology Services, the State Treasurer's Office, and the Office of the State Controller, however the Cash Management Plan was not amended to reflect this change. A revision of the Department's Cash Management Plan reflecting the successful completion and implementation of this project to accept electronic payments was submitted to the Office of the State Controller for review and approval on April 22, 2003. The Office of the State Controller approved the revision on April 29, 2003.

## **DISTRIBUTION OF AUDIT REPORT**

---

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

### **EXECUTIVE BRANCH**

The Honorable Michael F. Easley	Governor of North Carolina
The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
The Honorable Elaine F. Marshall	Secretary of State

### **LEGISLATIVE BRANCH**

#### Appointees to the Joint Legislative Commission on Governmental Operations

Senator Marc Basnight	Senate President Pro Tem
Representative James B. Black	Speaker of the NC House of Representatives
Representative Richard Morgan	Speaker of the NC House of Representatives
Members of the Local Legislative Delegation	NC House and Senate
Mr. James D. Johnson	Director, Fiscal Research Division

September 9, 2003

## ORDERING INFORMATION

---

Copies of this report may be obtained by contacting the:

Office of the State Auditor  
State of North Carolina  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

Telephone: 919/807-7500

Facsimile: 919/807-7647