

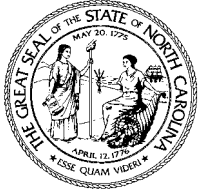
STATE OF NORTH CAROLINA

AUDIT RESULTS FROM
CAFR AND SINGLE AUDIT PROCEDURES
DEPARTMENT OF STATE TREASURER
FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR



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March 4, 2004

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
The Honorable Richard H. Moore, State Treasurer

We have completed certain audit procedures at the Department of State Treasurer related to the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report* for the year ended June 30, 2003. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

The results of these procedures, as described below, yielded an audit finding and recommendation for the Department related to the State's financial statements that may require disclosure in the aforementioned reports. We also identified during the current audit a significant deficiency in the management control processes for matters not directly related to financial reporting and federal compliance objectives. The findings noted above are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's responses follow each finding.

Our first audit finding discusses internal control weaknesses identified during our audit of the Teachers' and State Employees' Retirement System and the Local Government Employees' Retirement System. We noted that there were a significant number of old outstanding checks that had not cleared, many of which were payable to deceased individuals. Such outstanding items indicate potential erroneous payments that should be investigated in a timely fashion. We also noted a weakness in procedures for calculating revised benefits payable to beneficiaries when a retiree dies. The analysts who calculate the revised benefit and enter the change to the payroll file do so without supervisor review or authorization.

In our audit of the State Treasurer's Investment Funds, we determined that membership on the Investment Advisory Committee did not comply with the requirements of the *North Carolina General Statutes*. Subsequent to year-end, the Department corrected this condition.

The accounts and operations of the Department of State Treasurer are an integral part of the State's reporting entity represented in the *CAFR* and the *Single Audit Report*. In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the results of tests on the State's internal control and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget Circular A-133.

As part of the work necessary for issuance of the *CAFR* and the *Single Audit Report*, the following financial statement elements and federal compliance requirements of the State were subjected to audit procedures at the Department of State Treasurer as we considered necessary:

Comprehensive Annual Financial Report

- State Treasurer's Investment Funds
- Investment Trust Fund
- Teachers' and State Employees' Retirement System
- Local Government Employees' Retirement System
- General Long-Term Debt Accounts and Transactions

Single Audit Report

- Subrecipient Monitoring – Local Government and Public Authority Audit Reports
- Billed Central Service Costs – Employee Benefit Plans

The financial statement elements and federal compliance requirements subjected to audit at the Department of State Treasurer are substantially less in scope than would be necessary to report on the financial statements that relate solely to the Department or the administration of federal programs by the Department. Therefore, we do not express such conclusions.

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.



Ralph Campbell, Jr.
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following finding and recommendation was identified during the current audit and discusses a condition that represents a significant deficiency in internal control.

1. INTERNAL CONTROL OVER RETIREMENT BENEFITS NEEDS IMPROVEMENT

During our audit of the Teachers' and State Employees' Retirement System and the Local Government Employees' Retirement System, we noted two deficiencies in the design and operation of internal control over retirement benefits. As a result of these deficiencies, an increased risk of false or erroneous charges being made to the retirement benefits account exists.

- a. From our examination of monthly disbursing account reconciliations, we determined that there were a significant number of old outstanding checks that had not cleared. Approximately 22% of the dollar value of outstanding checks at April 30, 2003 had been issued for more than 90 days, with the oldest item dated in 1990. We also noticed that in many cases a single payee had outstanding checks for several consecutive months. Such outstanding items indicate potential erroneous payments that should be investigated in a timely fashion.

Of these old outstanding items, we tested checks for 50 payees and determined that 25 of the payees were reported as deceased on the Social Security Death Index web site. For 22 of the 25 reportedly deceased payees, we also found evidence in the individual's retirement file indicating that Department personnel either knew or suspected that the person had died. In four cases, the Retirement System was still issuing payments to people even though the files contained some indication that the payee was deceased, though an official death certificate had not been received. Based on information provided by the Department, subsequent investigation revealed that three of these four individuals were in fact deceased. For the 25 payees not reported as deceased on the Social Security Death Index web site, we were unable to determine why the checks had not cleared.

- b. We also noted a weakness in procedures for calculating revised benefits payable to beneficiaries when a retiree dies. The analysts who calculate the revised benefit and enter the change to the payroll file do so without supervisor review or authorization.

Agency personnel have cited a lack of sufficient staff resources as a major reason for the internal control problems. At the conclusion of our audit, procedures were being developed and attempts were being made to reorganize and hire staff to enable the agency to accomplish the needed control objectives.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Recommendation: We recommend that the Department continue their efforts to design and implement the internal control needed to ensure that old outstanding retirement benefit checks are properly investigated, that prompt action is taken to amend or cease benefits when a retiree dies, and that retirement benefit changes are reviewed and authorized by someone other than the person determining the revised benefit.

Agency's Response: The audit finding noted two deficiencies in the design and operation of internal control over retirement benefits. One item of concern pertained to the status of a significant number of old outstanding checks that had not cleared the monthly disbursing account. The other item of concern pertained to the procedures used for calculating revised benefits when a retiree dies.

In regards to the first item, after receiving preliminary comments from your auditors on this matter last June, we reviewed our process of determining outstanding checks and also found deficiencies in that process. We revised the process and ultimately determined there were some 1,300 outstanding payments, and have assigned additional personnel to research these accounts and have currently resolved more than 50% of them. We anticipate being complete in the resolution of these outstanding checks within three months, and have also made modifications to this process to ensure a backlog is not created in the future.

Additionally, you noted that checks upon the Social Security Death Index reflected that 25 out of 50 payees reviewed were deceased. We have also modified our death processing procedures to require our personnel to check for outstanding checks on each report of death received. We have provided personnel access to an Excel spreadsheet listing all outstanding retirement payments, and are also in the process of developing a mainframe application to check for outstanding items. Once complete, this application will create efficiencies over the current process. We anticipate completion of this project in May.

The second item pertained to a weakness in procedures for calculating revised benefits payable to beneficiaries when a retiree dies. More specifically, you stated that analysts calculating revised benefits enter the change into the payroll file without supervisor review or authorization. During the exit conference, we discussed this matter at length as we wanted to make sure your staff understood the calculations involved and our plans to address this issue. In cases where survivorship benefits are payable, the amount payable in all but a few rare instances is either the same amount the retiree was receiving or 50% of the amount the retiree was receiving. Thus, the calculation required, if any, in these instances is quite simple. We also discussed our plans to create an internal audit function within the Retirement Systems Division and specifically an internal audit position within the Benefits Processing Section to randomly audit a portion of these and other calculations. Your staff agreed creation of this function would satisfy their concerns in this area.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Matters Not Related to Financial Reporting or Federal Compliance Objectives

The following finding and recommendation was identified during the current audit and discusses a condition that represents a significant deficiency in the management control processes for matters not directly related to financial reporting or federal compliance objectives. This finding was also reported in the prior year.

2. MEMBERSHIP ON THE INVESTMENT ADVISORY COMMITTEE DOES NOT COMPLY WITH STATUTORY REQUIREMENTS

During the 2002-2003 fiscal year, the membership of the Investment Advisory Committee did not comply with requirements of the General Statutes. This same condition was also reported for the prior fiscal year.

Under General Statute 147-69.2 (b1), the State Treasurer shall appoint an Investment Advisory Committee with five required members: the State Treasurer; two members selected from among the members of the boards of trustees of the Retirement Systems; and two members selected from the general public. Throughout the 2002-2003 fiscal year, less than two members of the Retirement Systems' boards served on the Investment Advisory Committee.

Department of State Treasurer staff have indicated that there was a delay in filling the openings on the Investment Advisory Committee because they were waiting on other officials to make appointments to the Retirement Systems' boards. With the Retirement Systems' boards complete, a greater number of people would be available for selection. However, subsequent to our inquiries, an additional appointment to the Investment Advisory Committee was made to serve as the second representative from the Retirement Systems' boards.

This finding is resolved: Subsequent to year-end, the State Treasurer made the final required appointment to the Investment Advisory Committee.

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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.

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Director, Fiscal Research Division

March 8, 2004

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