



STATE OF NORTH CAROLINA

RESULTS OF

STATEWIDE FINANCIAL AUDIT PROCEDURES AT THE

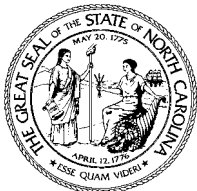
DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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April 6, 2005

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. William Ross, Secretary
Department of Environment and Natural Resources

We have completed certain audit procedures at the Department of Environment and Natural Resources related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2004. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements and to its federal financial assistance programs. Our 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 the Single Audit Act as applicable. Our audit scope at the Department of Environment and Natural Resources included the following:

State of North Carolina's Financial Statements

EPA Clean Water Revolving Loan Fund
EPA Drinking Water Revolving Loan Fund

State of North Carolina's Administration of Federal Financial Assistance Programs

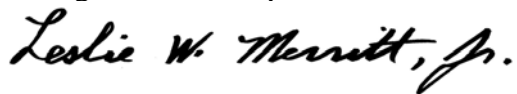
Capitalization Grants for Clean Water State Revolving Funds
Capitalization Grants for Drinking Water State Revolving Funds

Our audit procedures at the Department of Environment and Natural Resources were less in scope than would be necessary to report on the financial statements that relate solely to the

Department or its administration of federal programs. Therefore, we do not express such conclusions.

The results of our audit procedures yielded audit findings and recommendations for the Department related to the State's financial statements and federal financial assistance programs that may require disclosure in the aforementioned reports. These findings are included in the findings and recommendations section contained herein. Our recommendations for improvement and management's response follow each finding.

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 "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and discuss conditions that represent significant deficiencies in internal control.

1. WEAKNESSES IN CONTROLS OVER CASH RECEIPTS

Based upon our review of documentation and tests of internal controls, we found the following weaknesses related to cash receipts:

- Cash receipts were not controlled at the earliest point possible for the Divisions of Water Quality and Environmental Health. The Divisions did not prepare a mail receipt log of checks received through the mail for principle and interest payments for the Clean Water State Revolving Fund (CWSRF) and the Drinking Water State Revolving Fund (DRWSF). The Department's *Cash Management Plan* requires that all cash items received by mail be recorded on a receipt log. The risk that funds received through the mail may not be deposited increases when receipts are not listed on a mail log and reconciled to deposits;
- Accounting duties in the Division of Water Quality were not adequately segregated among personnel. One employee received funds, prepared journal vouchers, prepared checks for deposits, verified deposits, and keyed loan repayments to the Division's accounting subsystem. Improper segregation of duties may allow the opportunity for persons to both perpetrate and conceal errors or irregularities in the normal course of their duties;
- Controls were not in place to ensure that accounting code sheets were properly prepared for receipts of the CWSRF and DWSRF programs. Several accounting code sheets had no evidence of preparer and approval to indicate that the deposits were complete and the coding was accurate. The risk of error increases when transactions are not approved.

Recommendation: The Divisions should comply with the Department's *Cash Management Plan* and prepare the mail receipts log. In addition, receipts recorded in the log should be verified against the cash deposit to the bank. Accounting duties in the Division of Water Quality should be adequately segregated so that no one person is responsible for all aspects of a transaction. Further, accounting code sheets should be properly prepared, reviewed and approved.

Agency's Response: The mail receipts log was implemented prior to year end for the CWSRF program. Effective with the May 2004 collections, all deposits are balanced against checks recorded in the receipts log. The receipts log is being developed for the

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

DWSRF program. No one person is responsible for all aspects of transactions. Some employees are responsible for too many. The accounting staff for each program consists of two employees. This limits our ability to fully segregate duties. In the future, the Accounting Specialist II position for CWSRF will verify deposits and key loan repayments into the system. With the implementation of the receipt log, most risks should be minimized in the cash receipt process. We will stress the importance of proper sign-offs of all accounting code sheets with the Divisions.

It must be noted that all funds were appropriately deposited and accounted for in accordance with State Cash Management policies and procedures.

2. WEAKNESSES IN REVIEW PROCEDURES OVER CASH DISBURSEMENTS

Control weaknesses were noted in the Department's Controller's Office cash disbursing procedures. Under the current procedures, the accounts payable clerks received invoices and accounting code sheets, batched these into groups for keying, keyed data into the accounting system, verified that the batch total was entered correctly, and stamped paid on invoices for cancellation. However, there was no evidence that someone independent of the preparer reviewed the processed batches. Good internal control procedures require supervisory review of the batching process to determine that the batch totals agreed to the amount entered in the accounting system and that all transactions entered for payment were supported by an invoice.

Recommendation: The Department should implement review procedures for the cash disbursement process. These policies should be communicated to the appropriate staff.

Agency's Response: Procedures have been implemented to require the Accounts Payable Supervisor to perform spot checks of batches throughout the year and maintain a log of those batches checked.

It must be noted that all batches were balanced with the accounting system, that all payments were supported by invoices, and there were no duplicate payments.

3. CASH DISBURSEMENTS CONTROL PROCEDURES NOT CONSISTENTLY PERFORMED

The Department did not consistently follow prescribed procedures when processing cash disbursements. During our examination of a sample of sixty-seven disbursements, we found the following exceptions:

- Seventeen accounting code sheets were not signed by the person assigned to enter the information in the accounting system;
- Four cash disbursement accounting code sheets were not signed by the preparer;

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

- Seven cash disbursement accounting code sheets had the same preparer and approver;
- Ten disbursements had no evidence of cancellation on invoices or accounting code sheets;
- Three disbursements did not have the balancing tapes attached to the batch as prescribed by the Department's procedures.

Accounting code sheets should be completed properly to indicate that each step of the cash disbursement process has been completed. The risk of inappropriate disbursements or errors increases when there is no evidence that a task has been completed. Good internal controls would require a person other than the preparer to approve code sheets.

Recommendation: The Department should implement appropriate policies and procedures to ensure accounting code sheets are properly prepared and approved.

Agency's Response: We concur with the finding. Current procedures will be reiterated to employees as a reminder that all accounting code sheets must have the appropriate sign-offs, that all invoices are properly cancelled and batches are totaled and tapes attached.

It must be noted that all of the transactions were appropriate, and were accurately entered into the accounting system.

DISTRIBUTION OF AUDIT RESULTS

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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The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Mr. William Ross	Secretary, Department of Environment and Natural Resources

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April 13, 2005

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