



STATE OF NORTH CAROLINA

DEPARTMENT OF REVENUE

STATEWIDE FINANCIAL AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2007

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR



STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
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.ncauditor.net>

January 29, 2008

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Reginald S. Hinton, Secretary
Department of Revenue

We have completed certain audit procedures at the Department of Revenue 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, 2007. 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 Revenue included the following:

State of North Carolina's Financial Statements

General Fund – General Statewide Revenues and Related Accounts

Highway and Highway Trust Funds – Taxes and Related Accounts

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

None

Our audit procedures at the Department of Revenue 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 an audit finding for the Department related to the State's financial statements that may require disclosure in the aforementioned reports. This finding is included in the Audit Finding and Response section of this report.

The Department of Revenue's response to the finding identified in our audit is included in the Audit Finding and Response section of this report. We did not audit the response, and accordingly, we express no opinion on it.

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." with a stylized flourish at the end.

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

AUDIT FINDING AND RESPONSE

Matters Related to Financial Reporting or Federal Compliance Objectives

The following finding was identified during the current audit and discusses conditions that represent significant deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants.

DEFICIENCIES IN FINANCIAL REPORTING

During our audit, we determined there was an overstatement of revenues by \$74 million, taxes receivable by \$77 million, and tax refunds payable by \$3 million. These misstatements were due to the Department using a computer-generated report of all sales and use tax collections for the month of July as the base for estimating the amount of two accrual entries. This report had also been used in previous years for estimating the same accrual entries, but as a result of a law change, the report no longer provided an accurate amount for determining the estimates. In another instance, an entry was incorrectly dated, which caused it to be reported in the wrong fiscal year.

Recommendation: The Department should enhance internal control over year end accrual entries to ensure that the financial statements are complete and accurate.

Response: We agree with the recommendation by your office to enhance the internal control over the year-end accrual entries to ensure the financial statements are complete and accurate. The process for estimating revenues, taxes receivable and refunds payable will be evaluated each year to ensure any changes in the tax laws have been captured in the estimation process. The Department will also develop a spreadsheet for reconciling year end balances, to make sure all entries are keyed correctly.

[This Page Left Blank Intentionally]

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports 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

Telephone: 919/807-7500

Facsimile: 919/807-7647