

STATE OF NORTH CAROLINA

DEPARTMENT OF STATE TREASURER

STATEWIDE FINANCIAL STATEMENT AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF STATE TREASURER

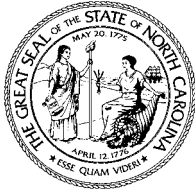
STATEWIDE FINANCIAL STATEMENT AUDIT PROCEDURES

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
The Honorable Janet Cowell, State Treasurer
Department of State Treasurer

We have completed certain audit procedures at the Department of State Treasurer 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, 2011. 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. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Our audit objective was to render an opinion on the State of North Carolina's financial statements and not the Department's financial statements. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

The audit finding referenced in the report is also evaluated to determine its impact on the State's internal control and the State's compliance with rules, regulations, contracts and grants. If determined necessary in accordance with *Government Auditing Standards*, the finding may be reported in the State's *Single Audit 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 cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

The Honorable Janet Cowell, State Treasurer
and Management of the Department of State Treasurer

As part of our audit of the State of North Carolina's financial statements, we have audited selected elements of the Department of State Treasurer's financial statements, as of and for the year ended June 30, 2011. Our report on the State of North Carolina's financial statements is included in the State's *Comprehensive Annual Financial Report*. Our financial statement audit scope at the Department of State Treasurer included the following:

- State Treasurer's Investment Pool
- Teachers' and State Employees' Retirement System
- General Long Term Debt Accounts and Transactions

The audit results described below are in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the State's financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a

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material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we consider the deficiency described in the Audit Findings and Responses section of this report to be a significant deficiency in internal control over financial reporting, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's response to the finding identified in our audit is included in the Audit Findings and Responses section of this report. We did not audit the response, and accordingly, we express no opinion on the response.

This report is intended solely for the information and use of management, the State Treasurer, others within the entity, the Governor, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

December 8, 2011

AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

DEFICIENCY IN INTERNAL CONTROL OVER THE COMPLETENESS OF NOTE DISCLOSURES

The Department of State Treasurer does not have sufficient procedures in place to ensure that all required disclosures are included in the financial statement information provided to the Office of the State Controller. The Department did not include a required investment risk disclosure in its financial statement information, which was corrected as a result of our audit. Without this correction, the disclosures in the State's *Comprehensive Annual Financial Report (CAFR)* would have been incomplete and could have been misleading to readers.

Under *North Carolina General Statutes* 143B-426.40H and 143D-7, it is the Department's responsibility to have controls in place to ensure the annual financial information presented to the Office of State Controller for inclusion in the State's *CAFR* is materially correct and in accordance with generally accepted accounting principles. These accounting standards include a requirement to disclose investments in one issuer that represent 5% or more of total investments. We found that at June 30, 2011 the Department held over \$5 billion of investments in the Federal National Mortgage Association, which represents approximately 6% of the investment pool's total investments. In the prior year, no investments in one issuer exceeded the 5% disclosure threshold, thus no such disclosure was required.

Required investment disclosures are voluminous and complex, and the Department accurately prepared the disclosures that are typically necessary. However, the Department did not add the investment concentration disclosure when the percentage of holdings increased beyond the reporting threshold. Internal controls should be designed to identify and adjust for such situations.

Recommendation: The Department should enhance its internal control procedures to ensure the financial disclosures it provides to the Office of the State Controller for inclusion in the State's *CAFR* are complete. One possible internal control to consider is using a disclosure checklist as a reminder to consider all of the disclosures that may be needed.

Agency Response: The State Treasurer agrees with the assessment that a proper system of internal controls should be in place in order to ensure that the financial statement disclosures in the *CAFR* are complete. For the fiscal year 2012, a disclosure checklist will be used to incorporate all possible disclosures to be made per Governmental Accounting Standards. This will identify missing disclosures in instances where the underlying facts change from year to year as they did in fiscal year 2011.

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