



STATE OF NORTH CAROLINA

DEPARTMENT OF STATE TREASURER
FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

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THE HONORABLE RICHARD H. MOORE

STATE TREASURER



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AUDITOR'S TRANSMITTAL

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

This report presents the results of our fiscal control audit of the Department of State Treasurer. 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 a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed a deficiency in internal control that is considered reportable under *Government Auditing Standards*. This item is 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.

Leslie W. Merritt, Jr.

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

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BACKGROUND INFORMATION

State law established the Department of State Treasurer under the supervision and direction of the State Treasurer. The duties of the State Treasurer include serving as the State's banker and chief investment officer, administering the public employee retirement systems and other employee benefit plans, issuing the State's general long term debt and overseeing the repayment of debt, assisting units of local government in the State in maintaining strong fiscal health, and administering the escheat and abandoned property program.

The Department is comprised of the following divisions: Retirement Systems, Unclaimed Property Program, State and Local Government, Financial Operations, Investment Management and Information Technology.

In the fiscal year ended June 30, 2006, the Department spent approximately \$40 million in the general fund (excluding debt service payments). Approximately \$25 million of the expenditures were for personal and contracted services and benefits, and \$8 million was transferred to the Firemen's and Rescue Squad Worker's Pension Fund.

Also for the year ended June 30, 2006, the Department paid benefits from its Pension and Other Employee Benefits Funds of over \$3 billion and collected over \$100 million of escheat property. Finally, at June 30, 2006, the Department was managing nearly \$78 billion (excluding securities lending collateral) in its Investment Pool and approximately \$6.6 billion in outstanding debt.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES

As authorized by Article 5A of Chapter 147 of the *North Carolina 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 Department of State Treasurer.

The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for issuing an opinion on internal control, and consequently, we have not issued such an opinion.

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 organizational units:

Financial Operations – This division performs the banking function for various State agencies, universities, community colleges, local school systems, boards and commissions. This involves managing funds belonging to the General Fund, the Highway Fund, and various pension and other funds. Other activities associated with the banking role include accounting, support and reconciliation functions. The accounting functions include accounting for investments, pension funds, trust funds and debt. Departmental support functions include budget administration, cash management, payroll and purchasing for the various divisions. Reconciliation functions include reconciling depository bank account statements and reconciling budgetary accounts with the Office of the State Controller.

Unclaimed Property Program – This organizational unit is responsible for administering the State's escheat and abandoned property program. This unit accounts for property escheated or abandoned throughout the State. They also refund escheated property to its rightful owners.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

During our audit, we considered internal control related to the following accounts and control objectives:

Personal Services – This account includes expenditures incurred for services rendered by permanent and temporary employees. Our audit covered personal service expenditures paid during the period July 1, 2005, through February 28, 2006, which amounted to nearly \$9 million in the general fund. We examined internal control designed to ensure that the Department properly accounts for and reports these expenditures.

Reimbursements – This account includes reimbursements from other funds for administrative costs paid on the other funds' behalf by the general fund. Our audit covered reimbursements paid during the period July 1, 2005, through February 28, 2006, which amounted to over \$7 million. We examined internal control designed to ensure that the Department properly accounts for and reports these transactions.

Capital Outlay – This account includes the purchase of furniture and equipment. Our audit covered capital outlay expenditures during the period July 1, 2005, through February 28, 2006, which amounted to approximately \$650,000 in the general fund. We examined internal control designed to ensure that the Department properly accounts for and reports these expenditures.

Escheat Transfers for Scholarships – Transfers are made from the Escheat Fund for scholarships as required by the Constitution and state law. Our scope covered transfers for the year ended June 30, 2005, which amounted to over \$58 million. We examined the internal control designed to ensure that the Department properly accounted for and reported the transactions and complied with the associated legal requirements.

Claims Payable – An estimated liability is reported in the Escheat Fund for the amount expected to be refunded to property owners. Our scope included the reported liability at June 30, 2005, which was over \$29 million. We examined internal control designed to ensure that the Department properly accounts for and reports this liability.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and/or performed direct tests of the accounts and transactions 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.

RESULTS

The results of our audit disclosed a deficiency in internal control that is considered reportable under *Government Auditing Standards*. This item is described in the Audit Findings and Recommendations section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

ESCHEAT CLAIMS PAYABLE NOT REASONABLY ESTIMATED

The Department of State Treasurer has not developed a methodology to reasonably estimate the amount of escheat claims payable at year-end. As a result, the reported amount could be misleading to users of the financial statements.

The Department holds abandoned property until the rightful owner claims it. Generally accepted accounting principles require that the Department estimate the amount of property held that will ultimately be refunded to claimants and report the amount in the year-end financial statements. The Department estimates the liability based on the ratio of refunds paid to the amount collected for one year. This methodology does not consider that all refunds paid in a year are not from the collections from one year. In any given year, refunds may be made from collections from the current year or any prior year.

Recommendation: The Department should refine its methodology for estimating the escheat claims payable. In determining the methodology, the Department should consider developing a historical record identifying the year of collection for each refund paid.

Agency Response: While preparing an estimate is not an exact science, we strive to determine the data elements necessary to prepare an objective estimate based on actual performance to minimize the risk of any misstatement. Prior to our increased outreach efforts to return escheated funds to their rightful owners, the estimate booked in the financial statements closely matched the actual amount refunded during that same time period. However, in the past few years, as both intake and claims have increased, the estimates have not closely mirrored actual payments.

We welcome your suggestion that the methodology for estimating the escheat claims payable be refined. We will look at process improvement options.

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