



STATE OF NORTH CAROLINA

DEPARTMENT OF LABOR
FISCAL CONTROL AUDIT

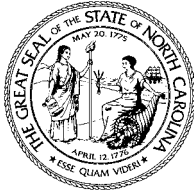
OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF LABOR

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AUDITOR'S TRANSMITTAL

July 14, 2009

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
The Honorable Cherie K. Berry, Commissioner

This report presents the results of our fiscal control audit at the Department of Labor. 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 performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in 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 deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses 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.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES, SCOPE, AND METHODOLOGY

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the Department of Labor. There were no special circumstances that caused us to conduct the audit, but rather it was performed as part of our effort to periodically examine and report on the financial practices of state agencies and institutions.

The objective of a fiscal control audit is to identify improvements needed in 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 rendering 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.

To accomplish our audit objectives, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

Our audit scope covered the period July 1, 2008 thru January 31, 2009 and included selected internal controls in the following organizational units:

Budget and Management

This organizational unit is responsible for all fiscal related functions of the Department, including budgeting, purchasing, receivables and other financial related reporting. This unit accounts for the financial transactions and issues financial reports covering the Department's operations.

Human Resources

This organizational unit is responsible for providing support to the Department's divisions in all areas of personnel administration.

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. The Department reported approximately \$12.1 million in personal service costs during our audit period. We examined internal control designed to ensure that the Department properly accounts for and reports these expenditures.

In-state Travel – These expenditures were to reimburse costs incurred by employees traveling on state business. The Department reported approximately \$793,270 of in-state travel costs during our audit period. We examined internal controls designed to ensure that reimbursement were made in compliance with state policy.

Travel Advances - These expenditures were made by the Department to employees traveling on state business. The Department issued travel advances of approximately \$55,200 during our audit period. We examined internal controls designed to ensure that advances were made in compliance with state policy.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report.

AUDIT FINDINGS AND RESPONSES

1. TRAVEL ADVANCES NOT IN COMPLIANCE WITH STATE POLICY

The Department of Labor issued travel advances to employees sooner than is allowed by state policy. As a result, cash that could have been invested or otherwise used by the State was not available.

The *North Carolina Budget Manual* states that employee travel advances may not be issued more than five working days prior to the actual date of departure. Department staff indicated they were not aware of this requirement. We tested ten travel advances and found seven, totaling \$5,336, that were issued to employees seven to 76 business days prior to the travel departure date.

Recommendation: The Department should strengthen internal controls to ensure travel advances are made in accordance with state policy.

Agency Response: The Department has attempted to provide timely travel advances to our employees when appropriate management has deemed these as needed. However, we agree that some travel advances were paid outside of the five working days limit prior to departure date. Staff has now been notified of this policy from the North Carolina Budget Manual and we will adhere to this policy. Our Accounts Payable Supervisor has been directed to audit the processing of these advances to help ensure that all future travel advances are made in accordance with this policy.

2. INSUFFICIENT CONTROLS OVER PAYROLL AND LEAVE

The Department of Labor did not have adequate controls in place for the monthly payroll and time reporting process. Our tests revealed the following deficiencies in internal control:

- The Department did not reconcile the total payroll amount processed by the state payroll system to the amount posted in the general ledger and the amount paid per the Cash Management Control System to ensure payroll costs were complete and accurate. As a result, there is an increased risk that a misstatement could occur and not be detected.
- The Department did not have adequate monitoring procedures in place to ensure employees' timesheets were reviewed and approved by their supervisors in a timely manner. The state payroll system pays salaried employees their full monthly pay rate unless their timesheet indicates otherwise. Supervisory personnel are responsible for reviewing and approving timesheets to ensure leave records are accurate and, if necessary, pay is docked. However, a monitoring process was not implemented to ensure supervisors consistently complete the review and approval process. As a

AUDIT FINDINGS AND RESPONSES (CONTINUED)

result, the Department is at risk of paying employees incorrectly and not maintaining accurate employee leave records.

- Since the implementation of the new state payroll system, the Department has been made aware of errors in the system's leave calculations. Other than asking employees to monitor their own leave balance and requiring supervisors to review and approve timesheets, management has not developed other strategies for ensuring the accuracy of leave balances. As a result, there is an increased risk that errors in employee leave records may not be detected timely.

Recommendation: The Department should strengthen its internal control monitoring procedures to ensure payroll costs and leave records are accurate.

Agency Response: The Office of the State Controller (OSC) did not provide a report for reconciling the general ledger to payroll and cash management until the Department asked that one be developed. In February 2009, OSC created ZFIR018 reports for reconciling requisitions in the Cash Management Control System to the state payroll system; however, adjusting entries were needed to the reports which negated a proper reconciling of state payroll to the month end general ledger. Departmental staff traveled to the OSC offices to discuss this problem with OSC personnel. As a result, OSC developed a ZFIR018 report so our staff can reconcile state payroll information to the accounting records once a month. Beginning March 2009 our staff has been running the ZFIR018 reports to ensure that cash management requisitions agree with state payroll records, and that the general ledger also agrees with what state payroll reports for payroll each month.

During the exit conference with us, Office of State Auditor representatives cited cases where some other state agencies had found a similar lack of OSC reconciling reports, while other agencies had found some means of obtaining OSC reports at earlier dates. This would appear to indicate that OSC should have provided more timely and uniform information to all state agencies regarding this systemic issue.

Our Human Resources Division has implemented and distributed a written policy for the employees to enter time data every week and for supervisors to check for accuracy and approve employee timesheets every week. Human Resources has trained its supervisors on the components of the time approval policy through newsletters and emails. Beginning July 1, 2009, Human Resources will run two recently established Beacon reports (*) to track employee time entry and supervisor approval of time entries. Human Resources will run these reports on a bi-weekly basis and follow up with employees and supervisors to ensure time entries are complete.

*Time Report CATC documents employees who have not entered time data for a specified date range. Time Report CATS_DA documents employees who have entered time data for a specified date range but whose time has not been approved by the supervisor.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Auditor Comment: In reference to the second paragraph of the agency response, the exit conference comments were made to emphasize that other state agencies had found an effective means to perform the reconciliations noted in this finding. Thus, similar efforts should have been taken by the Department of Labor. It was not intended to provide a comment or opinion on the timeliness or type of information being provided by the Office of the State Controller.

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