



STATE OF NORTH CAROLINA

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES
FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

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AUDITOR'S TRANSMITTAL

October 15, 2009

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Dee A. Freeman, Secretary, Department of Environment and Natural Resources

This report presents the results of our fiscal control audit at the North Carolina Department of Environment and Natural Resources. 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 North Carolina Department of Environment and Natural Resources. 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 (CONTINUED)

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

Division of Administration – Office of the Controller

This organizational unit is responsible for the general accounting functions of the Department. The unit accounts for the financial transactions and issues financial reports covering the Department's operations.

Division of Human Resources

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

Division of Water Quality

This organizational unit issues permits, monitors permit compliance, evaluates water quality and is the State's enforcer for violators of water and groundwater quality regulations. The Division is also responsible for statewide regulatory programs in groundwater and surface water protection.

Division of Air Quality

This organizational unit regulates the quality of the air in North Carolina through technical assistance to industries and enforcement of state and federal air pollution standards. The Division has programs for monitoring air quality, permitting and inspecting air emissions sources, developing plans for improving air quality, and educating and informing the public about air quality issues.

Division of Land Resources

The organizational unit promotes the wise use and protection of North Carolina's land and geologic resources. The Division is responsible for scientific investigations and maps; mining, dam safety, and sedimentation control programs; and serves as the State's official survey base to support mapping, boundary determination, and property delineation.

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

Environmental Violation Fines - These are fines imposed and collected for environmental violations with the State's water quality, air quality, or land regulations. During our audit period, over \$1.4 million was collected for such violations. We tested internal controls designed to ensure that cash received is safeguarded and deposited in accordance with applicable state laws and policies.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

Personal Services - This account includes the Department's payroll costs for permanent and temporary employees. The Department reported approximately \$91.3 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.

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.

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AUDIT FINDINGS AND RESPONSES

1. DEPOSITS AND RELATED CASH RECEIPTS NOT IN COMPLIANCE WITH STATE REQUIREMENTS

The Department of Environment and Natural Resources did not deposit checks received for environmental violation fines on a daily basis, as required by *North Carolina General Statute 147-77* and the state cash management plan. Also, the Department does not have adequate controls in place to ensure the receipt and processing of environmental violation fines are done in accordance with the Department's cash management plan. As a result, there is an increased risk that checks will be lost or misappropriated, and the State's investment earnings are reduced.

We tested five deposits of environmental violation fines and noted four deposits with checks valued at \$42,495 that were deposited from four to 45 days after receipt. This noncompliance with statute and state policy occurred because the controls, as outlined in the Department's cash management plan, are not being executed by each division. The state cash management plan and related policies require each state agency to develop and implement a cash management plan that is consistent with statutory requirements and the statewide cash management plan. During our audit we noted the following deficiencies:

- Checks received in the Division of Water Quality and the Division of Air Quality are not being recorded in a receipts log by the person who opens the mail as required by the Department's cash management plan. As a result, control over receipts is not established immediately. This increases the risk that an error or misappropriation could occur and not be detected.
- Checks received and held by the Division of Water Quality are not properly safeguarded as required by the Department's cash management plan. We noted that checks are stored in either an unlocked desk, an unsecured mailbox, or a locked cashbox that resides in an unlocked cabinet. This increases the risk that checks could be lost or misappropriated.
- Journal entries by the Division of Water Quality and the Division of Land Resources to record the cash receipts are not reviewed and approved as required by the Department's cash management plan. We tested 5 daily deposits of environmental violation fines and found that none of the related journal entry forms had been properly reviewed by someone other than the preparer. This increases the risk that an error could occur and not be detected.

Recommendation: The Department should implement internal controls to ensure that all receipts are deposited on a daily basis in accordance with state law and the state cash management plan. In addition, the Department should ensure that its cash management plan is implemented by the divisions.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: We agree that the Divisions of Water Quality, Air Quality and Land Resources did not follow State, DENR, or the division's policies and procedures. The following measures are being taken to ensure compliance in the future:

- We are re-evaluating cash management plans for all staff involved in handling checks received.
- Random audits for compliance to our cash management plans will be conducted. Findings will be documented and shared with the appropriate management.
- Cash management plans for the regional offices that make deposits will be reviewed and updated.
- All updated cash management plans will be sent to the DENR Internal Auditor for review.
- Training will be conducted for all staff involved in handling cash receipts and deposits.

2. INSUFFICIENT CONTROLS OVER EMPLOYEE TIMESHEETS AND LEAVE

The Department of Environment and Natural Resources did not have adequate monitoring procedures in place to ensure employee timesheets are reviewed and approved timely or to ensure employee leave records are accurate. As a result, the Department is at risk of paying employees incorrectly and having inaccurate leave records, which increases the risk of employees taking and being paid for leave they have not earned.

During our audit we noted the following deficiencies in internal control:

- The Department did not have adequate controls in place to ensure employees' working hours are entered and timesheets are reviewed and approved by 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 work and leave hours have been properly entered. Although management has not established a department-wide monitoring procedure, we found that some divisions are attempting to monitor the timesheet entry and approval process. However, this is not being consistently performed by all divisions. During our tests, we identified one employee who was paid but had not entered a full amount of hours worked for a month.
- The Department did not have adequate controls in place to ensure employee leave balances are accurate. We found that employee leave balances are reconciled only when an employee makes a specific inquiry about their balance. Despite noted errors in the payroll systems' leave calculations, management has not established standard guidelines for regularly verifying the accuracy of employee leave records.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Recommendation: The Department should strengthen its internal control monitoring procedures to ensure employees' working hours are entered and approved timely and implement procedures to ensure employee leave records are accurate.

Agency Response: During the time in question, the Department was working to correct many problems related to the recent SAP (BEACON) implementation. DENR Payroll, Human Resources (HR), managers and employees throughout the Department were working continuously to correct errors, train staff and ensure that information was correct in the new system. Time sheets were extensively reviewed by Payroll staff, HR staff, managers and employees during this period. Since that time, new reports and procedures have been developed that allow a more systematic, routine review of timesheets.

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