



STATE OF NORTH CAROLINA

DEPARTMENT OF COMMERCE

FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF COMMERCE

FISCAL CONTROL AUDIT



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the 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>

AUDITOR'S TRANSMITTAL

September 25, 2009

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
North Carolina Department of Commerce
J. Keith Crisco, Secretary

This report presents the results of our fiscal control audit at the Department of Commerce. 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

TABLE OF CONTENTS

	PAGE
OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS	1
AUDIT FINDINGS AND RESPONSES	5
ORDERING INFORMATION	11

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 Commerce. 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. Our results are reported for our selected sample items and we have chosen not to project our results to the population as a whole.

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:

Fiscal Management Division

This organizational unit is responsible for the departmental accounting, budgeting, and purchasing functions and for depositing the revenue collections of the various divisions and commissions of the Department. This unit also accounts for and issues financial reports covering all departmental operations.

Human Resources Office

This section performs departmental personnel functions including recruitment and selection, employee relations, training, salary administration, safety and benefits administration.

International Trade Division

The International Trade Division, through two domestic and seven foreign office locations, provides assistance to North Carolina businesses seeking to capitalize on overseas market opportunities. The Division aids in preparing marketing plans, handling export operations, providing market research, identifying best market prospects, advising on finance and insurance options and working to find customers and partners.

Trade consultants in Raleigh and High Point tap into resources and programs that help businesses grow through international sales. The Division's foreign offices in Canada, Mexico, Germany, China, Korea, Hong Kong, and Japan help North Carolina businesses enter new markets or expand market share.

North Carolina Alcoholic Beverage Control Commission

The purpose of the Alcoholic Beverage Control (ABC) Commission is to provide regulation and control of the manufacture, distribution, advertisement, sale, possession, and consumption of liquors, wines, and malt beverages. The ABC Commission controls the sale of alcoholic beverages in the State through operation of a centralized warehouse, oversight of the local government operated retail sales outlets, and permitting of facilities authorized to sell alcohol in bulk or by the drink.

The ABC Warehouse is a central warehouse for storage, distribution, and monitoring of all liquors sold by the 156 local county and municipal ABC boards in the State. The Commission contracts with LB&B Associates Inc. for the storage and distribution of spirituous liquor and the collection of all ABC bailment fees and surcharges for spirituous liquor distributed to the local ABC boards.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

North Carolina Cemetery Commission

The Cemetery Commission is responsible for the regulation and supervision of cemeteries, cemetery management organizations, cemetery sales organizations, cemetery brokers and individual pre-need cemetery salespeople licensed under the laws of North Carolina.

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

Personal Services – During the period audited, the Department reported a total of \$29.1 million in personal services expenditures. These expenditures are incurred and paid by the Department for services rendered by permanent and temporary employees and their related fringe benefits. We examined internal controls designed to ensure that expenditures were paid correctly and accounted for properly. We also examined internal controls designed to ensure compliance with applicable federal, state, and departmental requirements.

Fees, Licenses and Fines – During the period audited, the Department reported collections of \$27.1 million from fees, licenses and fines. These monies represent non-tax revenue collected from individuals or business entities for the privilege to engage in certain business activities. We examined internal controls designed to ensure that the Department appropriately collected and accounted for these funds. We also examined internal controls designed to ensure compliance with applicable state cash management requirements. Our audit of this area primarily focused on collections by the ABC Commission and the Cemetery Commission.

Travel Expenditures – During the period audited, the Department reported a total of \$1.6 million in travel expenditures. These expenditures are for the reimbursement of travel expenses incurred by employees for performing their job duties away from their home office and include such items as hotel, meals, and transportation costs. We examined internal controls related to the reimbursement of these expenditures to ensure that expenditures were paid correctly and accounted for properly. We also examined internal controls designed to ensure compliance with applicable state and departmental travel requirements. Our audit of this area primarily focused on expenditures by the International Trade Division.

The Department's oversight of its Foreign Office Contracts – The International Trade Division contracts with seven foreign offices that provide consultative services to North Carolina businesses seeking to capitalize on overseas market opportunities. We examined internal control designed to ensure that the Division properly manages those contracts as well as ensures compliance with the terms of the contractual agreements.

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.

[This Page Left Blank Intentionally]

AUDIT FINDINGS AND RESPONSES

1. DEFICIENCIES IN PERSONNEL AND PAYROLL PROCESSES

The Department has not established adequate internal control to ensure its personnel and payroll processes are administered effectively. As a result, the Department has not complied with state personnel policies and there is an increased risk that there will be errors in the compensation paid to employees and in the related accounts on the financial statements.

Several tests were performed for the period July 1, 2008 through December 31, 2008, that identified the following deficiencies:

Employee Work Plans and Performance Appraisals

Management did not formally communicate job responsibilities, expectations, and actual results to all employees. Such formal communication is required by state policies to ensure that employees effectively and efficiently carry out responsibilities to meet departmental goals. We judgmentally selected a sample of 12 employees from a population of 124 to determine if work plans and performance appraisals were properly maintained in employee personnel files. We noted that work plans for three employees were significantly outdated, the most recent update occurring in 1987, and did not sufficiently address the current duties required of those positions. In addition, performance appraisal documentation was not available or was not current for six of our sample employees. A rating had been assigned in the State's personnel management system for the employees; however, there was no documentation in the individual employees' files to substantiate the ratings.

Payroll Review

In our examination of the payroll processing procedures, there was no evidence to support the Department's review of available payroll error reports that assist in the verification of the accuracy of payroll expenditures prior to the actual disbursement of the funds. An examination of the BEACON Payroll Interface Detail Report for the month of December 2008 identified payroll processing errors totaling \$13,300; however, there was no evidence that the Department reviewed and addressed the reported errors. The failure to monitor and reconcile the reported variances could result in the improper payment of payroll expenditures.

In addition, the BEACON Payroll Interface Detail Report also provides the Department with verification that the payroll transactions have been properly classified and accurately presented in the accounting records.

Recommendation: We recommend that the Department improve its internal control over the personnel and payroll processes to address the deficiencies noted above.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: The Department will make every effort to make sure that work plans and performance appraisals are complete for all employees.

Because of lack of communication and training from Beacon, the Department did not have access to the reports addressed until January, 2009. The Department has been using these reports since that time. As for the \$13,300 payroll error, that error was due to a budget code error for two employees who transferred to the Banking Commission, a Special Fund, from a General Fund. All errors were corrected the following month.

2. DEFICIENCIES NOTED IN THE RECEIPTING PROCESSES AT THE ALCOHOL BEVERAGE CONTROL (ABC) COMMISSION

We noted deficiencies in the ABC Commission's processing of receipt transactions. As a result, there is an increased risk that there will be errors in the reported receipts and in the related accounts on the financial statements.

The ABC Commission has receipting subsystems that account for fees collected for permitting and enforcement violations, as well as collection procedures related to alcohol bailment and surcharge fees. We noted that the ABC Commission is not performing a reconciliation of the multiple receipting activities and the amounts subsequently recorded in the departmental accounting system. Reconciliation procedures performed by the Department's fiscal management section is not performed at a level of detail that would identify discrepancies in the reported receipting data. The Department's internal policy states that "the Division is responsible for verification of the accuracy of posting to NCAS (North Carolina Accounting System)."

We also noted that the ABC Commission's accounting for its accounts receivable is not in accordance with state guidelines. The ABC Commission does not record a receivable related to receipts collected by its warehouse contractor subsequent to year-end as part of its year-end financial procedures. In addition, we were unable to reconcile the receivable amounts identified either within the ABC Commission's Permit system or those identified as being collected by the warehouse contractor with similar information posted in the Department's accounting records (NCAS).

Recommendation: The ABC Commission should improve its internal control over the processing of receipt transactions to ensure amounts are properly recorded for financial reporting purposes as well as processed in accordance with applicable state guidelines.

Agency Response: Thank you for the opportunity to respond to your findings and recommendations as they relate to your audit of the Department of Commerce. The ABC Commission is committed to maintaining high standards and has safeguards in place to protect all public monies that we process. Our ABC software applications were not designed to be accounting systems. Monies are manually reconciled to activity, balanced and posted to code sheets. The monies and code sheets are delivered daily to the Department in locked bags for processing in the North Carolina Accounting System

AUDIT FINDINGS AND RESPONSES (CONTINUED)

(NCAS). We will work with the Department to insure that reconciliation procedures are performed by the Commission to verify the accuracy of the accounting information maintained by the Department. We have plans to redesign all ABC applications over the next several years and will work through the Department to ensure compliance with state guidelines is maintained at all times.

3. DEFICIENCIES NOTED IN THE COLLECTION PROCESSES AT THE CEMETERY COMMISSION

We noted deficiencies in the Cemetery Commission's collection and deposit of established fees. As a result, there is an increased risk that there will be errors in the reported receipts and in the related accounts on the financial statements.

The Cemetery Commission is responsible for the regulation and supervision of cemeteries, cemetery management organizations, cemetery sales organizations, cemetery brokers and individual pre-need cemetery salespeople licensed under the laws of North Carolina. Revenues are generated from the collection of monthly assessment fees, annual cemetery and salespersons licensing fees, periodic fees from cemetery changes of control, and audit fees. Monthly grave space and assessment reports are completed by cemeteries to support the submitted fees. In our review of the collection processes in place at the Cemetery Commission, we noted that the amounts being collected and deposited did not always agree with the supporting assessment reports. A sample of six deposits was reviewed and errors were noted with three of those deposits. Errors noted were:

- Review of the August 7, 2008 deposit revealed three underpayment errors. In two instances, the underpayments were collected and corrected in subsequent months. A remaining underpayment item of \$40 was not addressed until February 2009.
- Review of the October 2, 2008 deposit revealed three underpayment and three overpayment errors. In two instances, corrections were made in subsequent months; however, other errors that netted to a \$139 underpayment were not addressed until March 2009.
- Review of the December 12, 2008 deposit revealed one underpayment and one overpayment error. The overpayment error was corrected in the subsequent month. The underpayment error of \$5 was not addressed until March 2009.

The Cemetery Commission does not have processes in place to timely ensure that the correct amount of fees are being collected along with the establishment of receivable/payable balances for those instances where variances are identified.

In addition, we noted that the Cemetery Commission does not process its receipts on a daily basis. We identified instances where receipt activity exceeded minimum requirements established by state guidelines requiring a daily deposit. Other receipt items were held and not included as part of a deposit. Both practices are in violation of

AUDIT FINDINGS AND RESPONSES (CONTINUED)

the State's daily deposit requirement as specified in *North Carolina General Statute 147-77*.

Recommendation: The Cemetery Commission should improve its internal control over the collection and deposit of fees to ensure amounts are properly recorded for financial reporting purposes, as well as processed in accordance with applicable state guidelines.

Agency Response: For the 2008-2009 fiscal year, all collections were corrected and accounted for. The Cemetery Commission has implemented additional internal controls and enhanced existing controls to ensure correct amounts are remitted for assessments and fees to facilitate a perpetual listing of payables and receivables by remitter. The Cemetery Commission has also implemented internal controls to conform to the State's daily deposit requirement specified in *North Carolina General Statute 147-77*.

4. DEFICIENCIES NOTED IN THE MONITORING PROCEDURES FOR THE DEPARTMENT'S FOREIGN OFFICES

The Department of Commerce - International Trade Division does not have a consistent, formal method of evaluating the effectiveness of its foreign offices. As a result, there is an increased risk that foreign offices will not be consistently evaluated against established performance criteria or economic development resources may not be used in the most effective manner.

The Department maintains offices around the globe. Specialists within each office are assigned to either to support export activity or to facilitate foreign direct investment in the State. The International Trade Division performs monitoring activities of its foreign offices as established by contract; however, the required quarterly programmatic reporting by the foreign offices is informal and inconsistent across the seven foreign offices. We noted that some reporting occurred by way of e-mail correspondence. Supporting information was not always organized and similar data elements were not consistently gathered from each office for each reporting period.

Recommendation: The Department should establish consistent reporting procedures and formats to enhance the collection of information as required by contract and to provide for a consistent measurement of performance goals across its foreign offices.

Agency Response: The Office of the State Auditor reviewed the metrics that ITD uses to evaluate the foreign offices including monthly budget reports, monthly client/project target reports and yearly sales goals and found all these tools acceptable in measuring performance of the contractors and offices. These are driven by the Department's performance based budgeting process and these metrics and numbers are reported to the General Assembly each year.

In regards to a quarterly "state of the region report" that the FTRS submit via e-mail, the auditors felt these reports would be more effective if each county report was

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

standardized so that each office was including the same information. We agree that this is a worthwhile recommendation. All reports will now include the following information and hard copies will be mailed to the main office:

FTR State of the Region Reports

- FTR Name
- County/Region
- Date
- Major New Import Potential from North Carolina
- Current Import Activity from North Carolina
- Trade Shows scheduled for next 12 months
- New clients added since last report
- New industry developments in the region that will lead to new Import potential for North Carolina companies
- Other developments in the region

[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