STATE OF
NORTH CAROLINA

EMPLOYMENT SECURITY COMMISSION

FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

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STATE AUDITOR

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AUDITOR'S TRANSMITTAL

October 19, 2009

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Employment Security Commission
Mr. Moses Carey, Jr., Chairman

This report presents the results of our fiscal control audit at the Employment Security Commission. 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 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.

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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 Employment Security Commission. 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.

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

Finance and Accounting Services

This unit is responsible for the fiscal administration, accounts payable, payroll, and financial statement preparation and reporting activities of the Commission.

Budget Services

This unit is responsible for reviewing and approving expenditures that are allowable, reasonable and allocable and assigning the proper accounting code structure.

Human Resources

This unit is responsible for recruitment and compensation of the employees with the Commission. Human resources is responsible for creating and maintaining master data including personnel, salary and wage information in the payroll system.

Support Services - Purchasing

This unit is responsible for purchasing activities regarding contracted personal services, capital outlay greater than $500, and supplies and materials greater than $1,000.

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

Personal Services – These expenditures are made by the Commission for services rendered by permanent and temporary employees. The Commission reported personal services expenses of approximately $34.8 million during the audit period. We examined internal controls designed to ensure that the Commission properly accounted for expenditures regarding new hires and separated employees and complied with state personnel policies and federal regulations.

Contracted Personal Services – These are contracted expenditures for professional services in the program and administrative areas. The Commission reported contracted personal services of approximately $5.5 million during the audit period. We examined internal controls designed to ensure the Commission properly accounted for expenditures regarding contracted professional services and the receipt of services, and complied with state purchase and contract policies.

Capital Outlay – These expenditures are made by the Commission for equipment purchases in excess of $500. The Commission reported equipment purchases of approximately $1.1 million during the audit period. We examined internal controls designed to ensure the Commission properly accounted for expenditures regarding computer and office equipment, documented the receipt of goods, and complied with state purchase and contract policies.

Travel – These expenditures are made by the Commission to reimburse employees for business travel. The Commission reported travel costs of approximately $769,000 during the audit period. We examined internal controls designed to ensure the Commission properly accounted for expenditures regarding employee travel advances and reimbursements and complied with state budget travel policies.

Supplies and Materials – These expenditures are made by the Commission for purchases of non-capital items such as office supplies. The Commission reported supplies and materials purchases of approximately $624,000 during the audit period. We examined internal controls designed to ensure the Commission properly accounted for expenditures regarding supplies and materials, documented the receipt of goods, and complied with state purchase and contract policies.

RESULTS

The results of our audit disclosed deficiencies in internal control and 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. INAPPROPRIATE INFORMATION SYSTEM ACCESS

The Commission allowed employees to have system access rights that were not necessary for their assigned job functions. As a result there is an increased risk of errors and fraudulent transactions. We noted the following access deficiencies:

- In the tax auditor accounting module, we identified 34 employees with inappropriate update authority to system tables that control the mileage reimbursement rate and authorize field tax auditors to claim travel expenses.
- In the financial accounting subsystem, we identified 33 employees with inappropriate create/update/delete authority to groups including the general ledger, accounts payable, vendor master file, and receiving and invoice control groups.
- For the time information management system, we identified three employees with inappropriate access. Two employees were inappropriately authorized as time analysts and one employee was inappropriately identified as a human resource administrator. However, their access was limited to access reports and read access to timesheets.

Even though the managers periodically reviewed their employees' access rights, the data owners (for example, the Finance and Budget director is the data owner for the financial accounting subsystem) did not perform a review. The data owners are in a better position to know if an employee needs access to a particular system.

We also determined that there was no verification or monitoring by the Commission of system access roles in the payroll system. We identified one employee in the budget unit with roles that should have been restricted to human resources personnel. Another employee had human resource access roles that were needed during the implementation process but not for the employee's current job responsibilities.

Recommendation: The Commission should improve internal controls to ensure personnel are granted only the necessary system access to perform their job duties. Also, the Commission should require the data owners for each computer system to review access authority on a regular basis.

Agency Response: The UI Tax Department has reviewed the access to the tax system accounting module for all employees and has restricted and/or revoked access for employees with inappropriate access. Tax Department management staff will review access on a monthly basis.

We have reviewed the access to the financial accounting subsystem for all employees and have restricted or revoked access. Previously this was done on a quarterly basis for just department employees. In addition, we are now reviewing all employee access on a quarterly basis.

The TIME system was implemented in April 2008 with the new BEACON system. Since these were new systems, we granted access based on what we believed individuals would need. Now that the systems are relatively stable, we have restricted employee access as appropriate.

2. IMPROPER SEPARATION OF ACCOUNTS PAYABLE FUNCTIONS

The Commission did not have adequate separation of the accounts payable functions in the financial accounting subsystem. The accounts payable clerks were able to create a new vendor, create an invoice, review their own invoice, document receipt of goods, and schedule invoices for payment. Also, new vendors were not approved by the supervisor before being added to the master vendor file. These weaknesses increase the risk of improper payments.

Recommendation: The Commission should develop policies and procedures to ensure that the accounts payable functions are appropriately separated within the financial accounting subsystem. New vendors should be authorized by a supervisor before being added to the list of qualified vendors.

Agency Response: The Commission will implement procedures to ensure new vendors have proper approvals before being created. While the vast majority of receipt of goods is completed by the Warehouse staff, for those instances in which the Accounts Payable staff has to receive items, we will implement a separation control.

3. NO EVIDENCE OF RECEIPT FOR ON-LINE PURCHASES

The Commission did not require acknowledgement of receipt for on-line purchases prior to payment of the invoice. Without confirmation that the merchandise has been received, there is an increased risk that invoices will be paid for merchandise that was damaged, partially received, or never received.

During our examination of 40 payments for supplies and materials, we identified 14 on-line purchases for which the invoices were paid without evidence that the merchandise had been received. For the period under audit, we determined that there were 1,588 on-line purchases, totaling approximately $202,000.

Recommendation: The Commission should develop policies and procedures that require accounts payable personnel to obtain written acknowledgement of the receipt of merchandise purchased on-line before the invoice is paid.

Agency Response: Current policies and procedures require that each invoice from the on-line supplier be attached to an internal payment request form signed by the appropriate manager. We will reinforce the understanding that the manager's signature acknowledges receipt of the goods and will also ask that the packing slip be attached.

4. TRAVEL MILEAGE REIMBURSED INCORRECTLY

Untimely approvals caused a number of employees to be reimbursed for personal vehicle mileage at the incorrect rate. The Commission's tax auditors report travel mileage through an automated system. After supervisory approval, the system calculates the total mileage and reimbursement amount using the rate in effect at the time of approval rather than the rate at the time of travel. Five of the 48 travel payments tested were overpaid by $119 because of the mileage reimbursement rates changed between the time of the travel and the time of the approval.

The Commission did not have formal policies and procedures to provide guidance on how often tax auditor mileage should be approved. This weakness increases the risk of mileage claims being paid at an improper rate and noncompliance with state travel policy. We identified nine mileage reimbursements in which the time between the date of travel and date of payment ranged between 52 to 197 calendar days.

Recommendation: The Commission should develop policies and procedures to ensure that tax auditor mileage is reviewed and approved in a timely manner. Also, the Commission should periodically monitor for outstanding claims to ensure timely payments.

Agency Response: The Commission will modify system to ensure appropriate mileage rate is used for travel reimbursements for tax auditors and develop policies and procedures to ensure mileage is reviewed and approved in a timely manner. Monthly monitoring of outstanding claims will be reviewed and issues reported to management for timely resolution.

5. INADEQUATE CONTROLS OVER SALARY ADVANCES

The Commission did not have adequate internal controls over accounting for salary advances. There were no written procedures in place for tracking and collecting salary advances and the Commission did not maintain complete accounting records for the salary advances and repayments. These weaknesses increased the risk of error or fraud. We noted the following deficiencies:

- The tracking spreadsheets did not adequately track all the employees receiving salary advances, the date and check amounts, and the repaid amounts. Many of the employees were deleted from the tracking spreadsheet when they repaid the salary advance.
- Payment requests forms were not completed and/or retained for all employees receiving salary advances. Also, the payment request for one salary advance was initiated and approved by the same employee.
- Two salary advance checks were given to the employee who initiated the payment requests.

- One salary advance of $1,109 issued in November 2008 was not fully collected six months later.

Recommendation: The Commission should develop and implement written policies and procedures for requesting, approving, recording, tracking, and collecting salary advances.

Agency Response: The Commission had just transitioned to the new BEACON system in April 2008. During this audit period we were adding large numbers of staff to help with the increased workload demands because of the recession. Some staff was not being paid timely so salary advances were issued. Written policies and procedures for salary advances have now been formalized.

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