



STATE OF NORTH CAROLINA

DEPARTMENT OF REVENUE
FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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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

August 5, 2009

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Kenneth R. Lay, Secretary

This report presents the results of our fiscal control audit at the Department of Revenue. 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 Revenue. 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 – January 31, 2009 and included selected internal controls in the following organizational units:

Financial Services

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.

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 – These expenditures include the Department's payroll costs for permanent and temporary employees. The Department reported approximately \$41.4 million in personal service costs during our audit period. We examined internal controls designed to ensure that the Department properly accounts for and reports these expenditures.

Travel – These expenditures were to reimburse costs incurred by the employees while traveling on state business. The Department reported approximately \$1.2 million in travel expenditures during our audit period. We examined internal control designed to ensure the payments associated with mileage and lodging costs 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

TRAVEL REIMBURSEMENTS NOT IN COMPLIANCE WITH STATE POLICY

The Department of Revenue did not reimburse employees for mileage and lodging in accordance with state policy. As a result, the Department overpaid employees for mileage and reimbursed employees for lodging without the appropriate travel authorization documentation.

Based on documentation on file to support payments, the Department reimbursed employees for personal car mileage at a rate higher than allowed under state policy. The *North Carolina Budget Manual* allows state employees traveling more than 100 miles roundtrip to be reimbursed for personal car mileage at one of two rates, with the higher rate only allowed when a state-owned vehicle is not available. The manual also states that the reimbursable mileage is to be measured from the closer of duty station or point of departure to the destination. For our audit period, the Department's internal policies matched the state policy.

We tested a sample of 60 mileage reimbursements and found that 37 trips of more than 100 miles were paid for at the higher rate but were not supported by documentation indicating that a state-owned vehicle was not available. In addition, we identified five instances where the employees were reimbursed for a longer distance than allowed by state policy. As a result, the Department overpaid \$3,682 in mileage reimbursements.

The Department also reimbursed employees for lodging expenses without written documentation required by state policy. In order to qualify for reimbursement of lodging costs, the *North Carolina Budget Manual* requires employees to obtain prior written authorization for the trip and for a lodging reimbursement rate that exceeds the standard rate. The Department has not implemented adequate controls to ensure compliance with these state policies.

We tested a sample of 40 lodging reimbursements and found 12 payments that were not supported by a written authorization for the trip. We also noted five instances where the written authorization was granted after the date of travel. Of the 40 lodging reimbursements tested, 23 included reimbursements for excess lodging costs. We found four reimbursements for which the authorization for excess lodging costs was given after the date of travel.

Recommendation: The Department should strengthen internal controls to ensure compliance with state travel policies.

Agency Response: The Department agrees internal controls should be strengthened to ensure compliance. Some of that comes with additional education of the travel policies to the Department's staff. Effective May 1, 2009 the Department's travel policy was updated to ensure compliance with the travel guidelines set by the Office of State Budget and Management. The Division Directors were notified on April 29, 2009 by memo that all employees based in Raleigh who travel must provide the proper documentation in order to be

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

reimbursed for the standard business rate. The Division Directors were asked to share the information with their staff that travel for business. The Department will continue to educate its staff on the proper travel policies.

It has been the standard practice of the Department that all employees traveling overnight must have prior approval for travel. The Department will ensure all employees supply proper documentation to reflect the prior authorization.

ORDERING INFORMATION

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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