



STATE OF NORTH CAROLINA

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

FINANCIAL RELATED AUDIT

JUNE 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

FINANCIAL RELATED AUDIT

JUNE 2012

ADMINISTRATIVE OFFICERS

DEE A. FREEMAN, SECRETARY

ROD DAVIS, CONTROLLER



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

June 27, 2012

The Honorable Beverly Eaves 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 financial related audit at the 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 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
BACKGROUND AND GENERAL OBJECTIVES.....	1
METHODOLOGY.....	2
SCOPE AND SPECIFIC OBJECTIVES	3
RESULTS AND CONCLUSIONS.....	4
AUDIT FINDINGS AND RESPONSES.....	5
ORDERING INFORMATION	9

BACKGROUND AND GENERAL OBJECTIVES

BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Department of Environment and Natural Resources (DENR). 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.

DENR is the lead stewardship agency for the preservation and protection of North Carolina's outstanding natural resources. It also administers the operations of the Zoological Park, Museum of Natural Sciences and Aquariums.

GENERAL OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. The specific fiscal matters included in the audit are described in the Scope and Specific Objectives section of this report.

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. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the Scope and Specific Objectives section of this report 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 provide evidence about our audit objectives. 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 professional auditing standards. As discussed in the standards, 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 audit in accordance with generally accepted government auditing standards applicable to performance audits. 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.

SCOPE AND SPECIFIC OBJECTIVES

Our audit scope covered the period July 1, 2011 through December 31, 2011 and included selected internal controls in the following organizational units:

Controller's Office:

This unit is responsible for the general accounting functions for the operations of the Department of Environment and Natural Resources.

Division of Aquariums:

This Division's mission is to promote an awareness, understanding, and conservation of the natural resources associated with North Carolina's ocean, and other aquatic environments.

The Division operates three public aquariums located in Kure Beach, Roanoke Island, and Pine Knoll Shores, with a division headquarters being located in Raleigh. The Division opened Jennette's Pier in Nags Head in May 2011 as an educational fishing pier.

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

Admission Fees - This account includes revenues from admissions to the Aquariums. At December 31, 2011, the Department reported a total of \$2,828,413 in admission fees. We examined internal control designed to ensure that the Department properly accounts for and safeguards these receipts.

Rental of Property - This account includes revenues from the rental of the three Aquariums and Pier Facility for events such as weddings, corporate meetings, conferences, birthday parties, and other programs. At December 31, 2011, the Department reported a total of \$212,670 in rental income. Rental fees for renting the Aquarium facilities range from \$3,500 (minimum fee for renting the entire aquarium) to per hour charges for use of specific locations within the Aquarium's property. We examined internal control designed to ensure that the Department properly accounts for and reports these revenues. We also evaluated whether effective procedures were in place to ensure compliance with Departmental policies and the North Carolina Administrative Code related to the rental of the facilities. In addition we evaluated whether effective procedures were in place to ensure compliance with IRS rules and regulations relating to discounts given to employees that rent the facilities.

Purchasing Card Transactions - The Department uses a VISA purchasing card program to purchase low dollar value products in order to provide a more rapid turnaround of requisitions and to reduce paperwork. The Aquarium Division purchased supplies and services totaling \$281,386 during the audit period through the purchasing card process. We examined internal control designed to ensure that the Department properly accounts for the expenditures as well as evaluated whether effective procedures are in place to ensure that purchases are made in compliance with State purchase and contract regulations.

RESULTS AND CONCLUSIONS

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. INADEQUATE CONTROLS SURROUNDING CASH RECEIPTING

The Division of Aquariums (Division) did not have controls in its cash receipting process to ensure that voided transactions or returns were valid. As a result, there is an increased risk of errors or fraud occurring without detection. There was approximately \$52,000 in voided tickets and returns at the three aquariums during the period July 1, 2011 through December 31, 2011.

Customers who purchase an admission ticket and subsequently decide not to enter the attraction will have their admission ticket voided. Customers who purchase a ticket and subsequently decide to purchase a membership to the Aquarium Society will have their admission ticket returned and reissued with their membership. Our review of the process revealed the following:

- The Division does not have a formal policy regarding voided transactions and the processing of returns.
- Voided transactions or returns do not require independent supervisory review and authorization.

The Division expects the cashiers to write an explanation on the voided ticket or returned receipt and attach it to the daily cash receipt documentation but there is no evidence of supervisory review or authorization.

Recommendation: The Division should strengthen internal controls to ensure cash receipts are safeguarded and to ensure that voided transactions and returns are valid. Voided transactions and returns should be reviewed and approved by someone other than the individual who initiated the transaction.

Agency Response: In the spring of 2011, the Aquariums implemented a new comprehensive point-of-sale system (POS). During the implementation of this new system, the policies and procedures for processing refunds were overlooked.

We have requested that the point-of-sale system (POS) provider, Accelerando, change the cashier options to prevent cashiers from approving refunds in the POS system. This system change will require a “key approval” by another staff for all refunds.

Until this system change is made, the Aquariums have implemented a requirement that supervisor approval and signature must be on all refunds.

To comply with PCI compliance for handling of credit cards, all cashier transactions are captured by video surveillance equipment. Therefore, if a questionable transaction (refund) is discovered, then it can be reviewed on the recorded video to determine if the transaction was legitimate and handled correctly.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

We have also investigated the refunds reviewed during the audit (\$52,000). The primary reason for cash refunds is when the visitor discovers, after purchasing an admission ticket, that a substantial discount is available if they purchase a membership, in which case we void the first transaction. That, plus the higher than normal level of voided transactions that normally occur during new POS equipment training (in this case, from 7/1/2011 to 12/31/2011) we believe adequately explains the level of “refunds” during the audit period.

2. PROCEDURES NOT FOLLOWED FOR AQUARIUM RENTALS

The Division of Aquariums (Division) did not comply with the requirements set forth in the North Carolina Administrative Code (NCAC) relating to the use of the aquariums before or after normal operating hours. As a result, there is an increased likelihood that users of the facilities may not be aware of the rules governing the use of the facilities resulting in increased liabilities being assumed by the Division.

The NCAC 15A 28.0203 requires any group wishing to use the aquarium facilities before or after normal operating hours to enter into a written agreement. The agreement includes requirements such as requiring the user to provide adequate supervision for the activity planned and prohibiting illegal substances and firearms on the premises. The NCAC also requires the user to acquire prior permission from the Division director if alcoholic beverages are to be consumed on the property.

Our tests of a sample of 32 files for rental activities at the three aquariums and Jennette’s Pier revealed the following:

- Two activities did not have a written agreement between the user and the aquarium.
- Eleven events were not approved by the Division director even though alcohol was served at the event. The events were approved by the facility’s rental coordinator but not by the Division director as required.

Recommendation: The Division should ensure that all events have a written agreement with the user. Events where alcohol is to be served should be approved by the Division director.

Agency Response: Department management and the Division Director have reviewed the Aquariums’ rental policies and emphasized to the Aquarium Directors the need for a signed contract for each rental. Also emphasized was the requirement for the Division Director to approve in advance the consumption of alcoholic beverages at rental events. The requirement for Division Director’s approval of alcohol consumption at rental events at Jennette’s Pier was corrected immediately. All three Aquariums and Jennette’s Pier now require Division Director’s approval in advance for consumption of alcohol at rental events.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

3. EMPLOYEE DISCOUNTS NOT TAXED

The Division of Aquarium's (Division) policy regarding the employees' free use of the aquarium facilities does not address the fact that these discounts may be considered taxable fringe benefits to the employees. Seven employees were granted \$13,910 in free or discounted rentals of aquarium facilities during the audit period. Per the guidance set forth in IRS Publication 15B, the IRS considers employee discounts over 20% of the price charged to nonemployee customers, to be considered a taxable fringe benefit. Using IRS guidelines approximately \$10,628 of this total should have been reported as taxable fringe benefits.

The Division's Staff Facility Rental Use Guidelines allows full time state employees of the Division Office, the Aquariums, and full time employees of the Aquarium Society one free rental of an aquarium facility each calendar year. However, the guidelines do not provide information regarding a potential taxable event due to the employee's use of the facility.

Recommendation: The Department should ensure that IRS guidelines are followed regarding employee discounts.

Agency Response: The Aquariums have changed their rental policy for employees of the Aquariums and the Aquarium Society. Employees of the Aquariums and the Aquarium Society will no longer receive a free annual use of one of the Aquariums. Now, employees will receive a 20% discount on the rental rate for use of one of the Aquariums. This complies with the IRS allowance of a 20% discount for employees as being non-taxable. Department management is working with the Office of the State Controller to determine the corrective action for past events.

[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