



STATE OF NORTH CAROLINA

DEPARTMENT OF CULTURAL RESOURCES

FINANCIAL RELATED AUDIT

MAY 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

May 21, 2012

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
Linda A. Carlisle, Secretary
North Carolina Department of Cultural Resources

This report presents the results of our financial related audit at the Department of Cultural 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 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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BACKGROUND, GENERAL OBJECTIVES, AND METHODOLOGY

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 Cultural 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 North Carolina Department of Cultural Resources was formed in 1971 to recognize and promote culture and heritage as essential elements of North Carolina's economic and social well-being. It was the first state organization in the nation to include all agencies for arts and culture under one umbrella. According to its website, Cultural Resources serves more than 19 million people annually through the Arts, the State Library of North Carolina, and the Office of Archives and History.

The North Carolina Department of Cultural Resources includes the State Library, the State Archives, 27 historic sites, seven history museums, Historical Publications, Archaeology, Genealogy, Historic Preservation, the North Carolina Symphony, the North Carolina Arts Council, and the North Carolina Museum of Art.

GENERAL OBJECTIVE

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters.

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 objective, 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, SPECIFIC OBJECTIVES, AND RESULTS

SCOPE AND SPECIFIC OBJECTIVES

Our audit scope covered the period of May 1, 2011 through October 31, 2011. During our audit, we considered internal control related to the following accounts and specific objectives:

Capital Assets - This account includes land, buildings, and arts and artifacts acquired either through purchase or donation with an initial cost or donated value of \$5,000 or more and an estimated useful life greater than one year. Construction-in-progress was included within this classification. At June 30, 2011, the Department reported a total of \$163.5 million in capitalized assets for land, buildings, and arts and artifacts and \$133.3 million in construction-in-progress expenditures. We examined internal controls designed to ensure the Department properly accounts for and safeguards these assets.

Capital Outlay for Buildings - Capital expenditures made by the Department for design, construction, and/or enhancement to buildings are recorded in this account. During our audit period, the Department reported \$5.7 million in building capital outlay expenditures. We examined internal controls designed to ensure compliance with state laws and the *North Carolina State Construction Manual*

Grants, State Aid and Subsidies - State disbursements to governmental and nongovernmental organizations for the Aid to Public Libraries grant, NC Arts Council grants, and grants to the North Carolina Symphony are recorded in this account. As of October 31, 2011, the Department reported state grant fund expenditures of \$9.6 million. We examined internal controls designed to ensure that the Department effectively monitored grants for compliance with program goals and objectives as well as laws related to the administration of state grant funds.

Fees, Licenses, and Fines - This account includes admission fees to historic sites, Historic Preservation Tax Credit review fees, Archives and Record Management Program fees, and North Carolina Award fees. During our audit period, the Department reported \$1.4 million in admission and other fees. We examined internal controls designed to ensure that the Department complied with applicable laws and regulations related to the collection and deposit of the fees.

Travel - Expenditures made by the Department to reimburse costs incurred by employees traveling on official state business are recorded in this account. During our audit period, the Department reported \$286,607 in travel expense. We examined internal controls designed to ensure that reimbursements were properly approved and reimbursed in compliance with state laws and the *North Carolina Budget Manual*.

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.

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AUDIT FINDINGS AND RESPONSES

Agency's Summary Response to Audit Findings

The Department of Cultural Resources provided the following summary response to the audit findings in addition to the specific responses listed under each individual finding:

The North Carolina Department of Cultural Resources (DCR) concurs with the findings and recommendations of the Office of the State Auditor from the recently completed financial-related audit. Most of the issues noted in this report were created during prior administrations. For the past two years, the current administration and financial staff have been aware of and working towards correcting them. However, due to managing staff cuts and budget cuts of \$13 million, staff has been delayed in focusing the attention needed to fully correct these areas. We appreciate the State Auditor's help in clarifying these issues.

Audit Findings and Specific Responses

1. CAPITAL ASSETS HAVE NOT BEEN EFFECTIVELY MANAGED AND REPORTED

The Department has not effectively managed and reported its capital assets. As a result, the State's financial statements may not be accurate and assets may not be properly insured.

The North Carolina Office of State Controller establishes statewide policies and procedures for managing and reporting capital assets. The Department reports and tracks its capital assets using the state accounting system's fixed asset module. In addition, state agencies are required to report changes to its buildings and land parcels to the Department of Administration's State Property Office.

The Department has not reconciled its assets shown in the fixed asset module to the State Property Office's database as required by state policy. We were unable to perform a complete reconciliation ourselves due to a lack of common identifying information between the systems; however, we did note that there were 191 more land parcels and 121 more buildings in the database than recorded in the fixed asset module.

Also, the Department does not have internal policies and procedures detailing its specific capital asset requirements as required by statewide capital asset policies. As the Department's assets are located throughout the State, such policies would provide greater clarity and direction to staff responsible for overseeing the assets.

For each of the asset classes listed below, we selected a sample of assets and examined documentation supporting the asset's acquisition and initial valuation. We also attempted to agree the individual assets and amounts shown in the fixed asset module to the State Property Office's database. In addition to our department-wide tests, we also specifically examined assets at some of the Department's historic sites.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Land - We tested a sample of 22 land parcels and found 7 parcels recorded in the fixed asset module at a cost that differed from the deed price, ranging from an understatement of \$1,200 to an overstatement of \$23,200. Documentation was not available to support other charges that may have been incurred to purchase the land. In addition, there was no documentation to support ownership or valuation of one land parcel.

For six of the seven historic sites visited, we found differences between the land shown in the fixed asset module and land listed in the State Property Office's database. Variances included valuation differences as well as items missing from the listings.

Buildings - We tested a sample of 36 buildings and found 28 buildings recorded in the fixed asset module at a cost that differed from either the State Property Office's database or documentation supporting the acquisition. The Department was unable to provide supporting documentation for three buildings.

We visited seven historic sites and found buildings at six sites that were not in the fixed asset module.

Art and Artifacts - The Department was unable to provide documentation supporting the values reported in the fixed asset module for the State Library, the Museum of Art Library, or the Historic Sites art and artifacts collections. There were also three arts and artifacts collections owned and insured by the Department at a value of \$21.8 million that were not included in the fixed asset module. Finally, there was an additional collection insured at a value of \$1.3 million not included in the fixed asset module for which we could not determine whether the Department or a third party owned the collection.

Construction-in-Progress - The Department's construction-in-progress balance consisted of nine projects, five of which were complete and should have been reported in the fixed asset module. Two projects were reported as complete in the fixed asset module but also continued to be reported as part of construction-in-progress.

Recommendation: The Department should strengthen internal control over the management and reporting of capital assets. The Department should develop internal policies and procedures that provide guidance on the Department's capital asset requirements. Those policies should address capitalization, proper valuation, and completeness of the records. The Department should reconcile its capital asset records to the State Property Office's database, as well as to individual historic site inventory listings. The Department should explore including common identifiers in the various systems to make reconciliation easier.

Agency Response: A majority of the capital assets errors noted in the report for land and buildings were acquired between the 1920s and the 1990s. Previous financial staff under

AUDIT FINDINGS AND RESPONSES (CONTINUED)

prior administrations processed and recorded these transactions. Previous staff also removed all capital assets valued at less than \$1,000, which is why the auditors could not reconcile to the State Property Office listing. In the past, DCR received numerous donated properties improperly recorded at less than \$1,000, instead of the fair market value.

DCR has since entered those capital assets back into the Fixed Asset System at the proper value at the time they were donated. Therefore, the Fixed Asset System now reconciles with the State Property Office listing.

We are correcting the capital assets issues noted. Current policies and procedures are in place for the proper reporting of capital assets. The procedures will include reconciling capital assets against the State Property Office listing on an annual basis prior to year-end physical inventory.

2. DEPARTMENT'S ASSETS ARE NOT PROPERLY INSURED

The Department has not properly maintained insurance on its assets. As a result, the State has an increased risk of financial loss.

State agencies must insure state property against losses caused by fire and lightning and may choose to have additional coverage for property under its control. The North Carolina Department of Insurance Risk Management Division provides guidelines to agencies on how to value their property for insurance purposes and to avoid needless insurance premiums. During our review of capital assets, we also examined the Department's insurance coverage for adequacy and noted the following:

- Three buildings from our sample of 36 were not insured.
- Nine buildings are potentially insured for an improper amount, as we were unable to review supporting documentation for the insured values.
- One building that department staff indicated is no longer being used is still insured.
- The Department is paying for insurance coverage for two arts and artifacts collections that are not owned by the Department. There are no documented loan agreements detailing the terms and obligations of the Department, so it is unclear who bears the risk for loss.

Recommendation: The Department should strengthen its procedures for determining proper insurance coverage for its assets. Insured assets should be reconciled to the Department's inventory of capital assets. Written loan agreements should be in place to document the obligations of the Department and the third party for providing insurance and establishing a timeline for the loan of the artifacts.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency Response: For years, the responsibility for determining insurance values has been a decentralized process within DCR. However, it has now been centralized and is assigned to the staff in the Capital Projects Section, who have the expertise needed in assigning proper replacement values. Policies and procedures have been developed to address insurance valuation and reconciliation to capital assets. We are correcting the insurance issues noted.

To clarify the issue raised concerning insurance coverage for the two arts and artifacts collections, DCR does not pay insurance on these collections. The Commissions at the two sites own and insure their artifacts. Only one of the two collections is on loan with a historic site, and we have prepared an agreement for that collection. The other collection resides with the Commission, so there is no need for an agreement.

3. DEPOSITS ARE NOT IN COMPLIANCE WITH STATE REQUIREMENTS

The Department did not deposit receipted funds in accordance with state requirements or the Department's cash management plan. As a result, there is an increased risk that monies could be lost or misappropriated.

North Carolina General Statute 147-77 requires funds belonging to the State of North Carolina to be deposited daily unless the State Treasurer grants an exemption. All collections equal to or greater than \$250 must be deposited when collected.

We identified that the State Historic Preservation Office made a deposit of \$10,500 on October 12, 2011 that included amounts receipted as early as August 2011, as well as individual receipts greater than \$250. Conversations with the administrator indicated that she was unaware of the requirements.

Recommendation: The Department should strengthen internal control to ensure that receipts are deposited in compliance with *North Carolina General Statute 147-77*. Further, the Department should ensure that requirements are communicated to all of its outlying cash collection areas.

Agency Response: The Department's cash management plan, including daily deposit requirements, has been communicated to outlying cash collection areas. The Accounts Receivable section will require a daily deposit certification form from outlying cash collection areas certifying either the amount of the deposit or no receipts were received.

4. GRANTS HAVE NOT BEEN EFFECTIVELY MONITORED

We identified deficiencies in the Department's monitoring procedures for the Aid to Public Libraries and North Carolina Arts Council grants. These deficiencies result in an increased risk that noncompliance at the grantee level could occur and not be detected timely.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Department is responsible for monitoring the awards of state funds to grantees to ensure that grantees perform all agreed-upon procedures, comply with applicable rules and regulations, and achieve desired outcomes.

Monitoring procedures for the Aid to Public Libraries locations have not been designed to address whether the grantee is complying with state and program regulations. The Department performs site visits but only uses the visits to collect data necessary for reporting.

We examined 60 of the Department's final report reviews for grantees receiving Arts Council grants. We noted three instances of noncompliance with program spending requirements that the Department either failed to identify or properly follow up.

We performed site visits at three libraries receiving Aid to Public Libraries funds and noted that one library did not report all of the local funds it received and did not comply with board member term limits as specified in program regulations. We performed site visits to three grantees receiving Arts Council grant funds and noted one instance where the grantee reported the incorrect information to the Department, impacting its grant matching requirements.

Recommendation: The Department should strengthen its grantee monitoring for the Aid to Public Libraries and Arts Council grants. Procedures should be enhanced to ensure that grantees perform all agreed-upon procedures, comply with applicable rules and regulations, and achieve desired outcomes. When deficiencies are found, the Department should ensure that grantees take proper corrective action and that documented follow-up occurs to verify the corrective action.

Agency Response:

State Library:

The State Library will strengthen desk review and monitoring procedures for the Aid to Public Libraries following 09 NCAC 03M.0401 (06) to ensure that all of the public libraries receiving state aid funds are established consistent with the provisions of Article 14, Chapter 153A of the North Carolina statutes and meet the eligibility requirements within 07 NCAC 021.0201. The corrective actions the State Library plans to take are:

1. All applications and required forms will be revised to strengthen the assurances of compliance.
2. Desk review procedures for all phases of the grant's life cycle will be revised to ensure compliance with all laws and regulations.
3. Monitoring through annual site visits will be enhanced to ensure compliance with all laws and regulations.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

4. Procedures for noncompliance and/or deficiencies will be enhanced to ensure grantees take proper corrective action. All follow-up and corrective actions will be documented.

NC Arts Council:

With regards to the finding of three instances of noncompliance with program spending requirements that the Department either failed to identify or properly follow-up, in each instance, the Arts Council staff worked with the grantees on these issues and made exceptions and provided the reasons to the auditors. However, in all cases, notes explaining the situations were not made by the staff on the checklists as they should have been. The Arts Council is making adjustments in the checklists based on the auditor's suggestions and is adding more oversight for the final report approval process to the Grants Office's responsibilities.

The auditors made a site visit to a grantee and found that it had reported incorrect information about its grant matching requirements. When the auditors pointed this out, Arts Council staff immediately set up a meeting with the grantee. The grantee staff was confused about the matching requirement. Once Arts Council staff examined their financial records, they were able to determine that the grantee had more than met the matching requirements. They then filed an amended final report.

5. MONITORING OF HISTORIC SITE ADMISSION FEES CAN BE IMPROVED

The Department's monitoring of admission fees at historic sites can be improved. Insufficient monitoring may result in fees not being charged and collected in accordance with state regulations and departmental policies.

Certain historic sites collect admission fees from visitors and report deposit information to the Department daily. We noted that the forms used by the sites were inconsistent, resulting in some sites reporting detailed sales information while others report deposit information only. The Department does not provide guidelines to the various historic sites to ensure consistent reporting of admission data, including ticket sales type and count. Use of one consistent process with all of the necessary detail would make it easier for the Department to monitor the revenues collected.

The Department does not effectively monitor to ensure the accuracy of the admission fees charged. During our site visits at two fee-collecting sites, we noted that one site was charging fees that were not in accordance with the approved fee schedule in the *North Carolina Administrative Code*. The Department reconciles the amounts deposited by the various sites to the amounts reported and recorded in the financial records, which helps ensure the completeness of the deposits but does not ensure that proper amounts were charged.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Recommendation: The Department should strengthen its monitoring of historic site admission fees. Policies and procedures should address consistent and complete reporting of ticket sales and collections. The Department should also consider including a review of collection activities in its departmental monitoring plan to ensure compliance with state requirements.

Agency Response: DCR is developing policies, procedures and a standard template to address consistent and complete reporting of ticket sales and review of collection activities.

Regarding the site noted as charging a fee not in accordance with the administrative code, the site was gauging the best price point for one particular ticket type. Due to budget cuts, the site had not settled on a new fee amount. DCR will be updating the administrative code with the new fee amount once the best price point is determined. The site is scheduled for additional budget cuts for the second year of the biennium. Therefore, it is crucial that the proper price point be established before the administrative code is updated.

6. DEPARTMENT DID NOT ALWAYS ENSURE THAT TRAVEL EXPENDITURES WERE PROPER

The Department did not consistently ensure that travel reimbursements were valid, properly recorded, and in compliance with state travel rules. As a result, there was an increased risk of improper payments and erroneous accounting entries.

The *North Carolina State Budget Manual* provides rules for state agencies concerning the reimbursement of allowable travel expenditures. We examined 60 items for compliance with provisions in the State Budget Manual and noted the following:

- Four reimbursements were not supported by proper documentation as required. The unsupported payments totaled \$524 out of a grand total of \$13,561 tested.
- One of the four items discussed above was also recorded incorrectly in the accounting records.
- Documentation needed to validate one reimbursement was not present at the time the reimbursement was reviewed and approved.

Recommendation: The Department should strengthen internal control over travel expenditures to ensure that reimbursements are valid, properly recorded, and in compliance with provisions of the State Budget Manual.

Agency Response: DCR has updated the travel policy and procedures to include a travel checklist to ensure that reimbursements are valid, properly recorded, and in compliance with the provisions of the State Budget Manual.

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