STATE OF NORTH CAROLINA

AUDIT OF THE UNEMPLOYMENT INSURANCE TAX APPLICATION CONTROLS

EMPLOYMENT SECURITY COMMISSION

DECEMBER 2008

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Mr. Henry Payne, Chairman,
North Carolina Employment Security Commission

Ladies and Gentlemen:

We have completed our information systems (IS) application audit at the Employment Security Commission. The audit was conducted in accordance with *Government Auditing Standards* and *Information Systems Audit Standards*.

The primary objective of this audit was to evaluate controls for the Unemployment Insurance Tax System (UI Tax) application. The scope of our audit was to review the application controls for the UI Tax application. Application controls for the UI Tax application systems include data completeness, data accuracy, data validity, data authorization, and data retention. The purpose of application controls is to ensure that as data passes through the UI Tax application, it is complete, accurate, valid, and it is protected from unauthorized access.

This report contains an executive summary that highlights the areas where the Employment Security Commission, has performed satisfactorily relevant to our audit scope and where improvements should be made.

We wish to express our appreciation to the staff at the Employment Security Commission, for the courtesy, cooperation, and assistance provided to us during this audit.

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.

Respectfully submitted,

Leslie Merritt

Leslie Merritt, Jr., CPA, CFP
State Auditor

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We conducted an information systems (IS) audit of the Employment Security Commission (ESC), from April 15, 2008, through October 24, 2008. The primary objective of this audit was to evaluate controls for the Unemployment Insurance Tax (UI Tax) application. The UI Tax application is a compilation of many programs which produces both state and federal reports. The following UI Tax reports and associated programs were evaluated during this audit: [State Reports] Daily Bank Deposit Report, Summary Report for Accounts Receivable, Summary Report for Accounts Payable, Month Accounts Receivable Totals, Computation of Accounts Receivable Collectivity, E-Government Totals, EFT Debit Payments Processed, and Credit Card Payments Processed and [Federal Report] ETA 581- Employer Contributions.

The critical application controls that we tested in this application review are: (a) data completeness, (b) data accuracy, (c) data validity, (d) data authorization, and (e) data retention. Our conclusions for the application review of the UI Tax application are organized into these four categories. Based on our objectives, we report the following conclusions.

Data completeness controls are designed to ensure that all transactions are entered into the system once and only once, that all errors are corrected without any being lost, duplicated or added, that all transactions are processed, that databases are updated completely, and that all output reports are complete. Our audit did not identify significant weaknesses in the completeness controls which produce the following reports: Daily Bank Deposit Report, Summary Report for Accounts Receivable, Summary Report for Accounts Payable, Month Accounts Receivable Totals, Computation of Accounts Receivable Collectivity, E-Government Totals, EFT Debit Payments Processed, and Credit Card Payments Processed. We were not able to examine completeness controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

Data accuracy controls ensure that the details of transactions are entered and processed correctly, and that printed output is not distributed to the user until it is checked for reasonableness. Our audit did not identify significant weaknesses in accuracy controls which produce the following reports: Daily Bank Deposit Report, Summary Report for Accounts Receivable, Summary Report for Accounts Payable, Month Accounts Receivable Totals, Computation of Accounts Receivable Collectivity, E-Government Totals, EFT Debit Payments Processed, and Credit Card Payments Processed. We were not able to examine data accuracy controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

Data Validity ensures the data entered into the application is valid. Data is compared with the type of data that should be properly included in each input field. In addition, a division of roles and responsibilities should exist, which should exclude the possibility for a single individual subverting a critical process. Our audit did not identify significant weaknesses in validity controls which produce the following reports: Daily Bank Deposit Report, Summary Report for Accounts Receivable, Summary Report for Accounts Payable, Month Accounts Receivable Totals, Computation of Accounts Receivable Collectivity, E-Government Totals,

EFT Debit Payments Processed, and Credit Card Payments Processed. We were not able to examine data validity controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

Data Authorization controls are designed to ensure that access to data is appropriate and authorized and that access is granted on a need to know, need to use basis. The access control environment should consist of access control software and information security policies and procedures that are implemented appropriately to protect the application data. Our audit did not identify significant weaknesses in authorization controls which produce the following reports: Daily Bank Deposit Report, Summary Report for Accounts Receivable, Summary Report for Accounts Payable, Month Accounts Receivable Totals, Computation of Accounts Receivable Collectivity, E-Government Totals, EFT Debit Payments Processed, and Credit Card Payments Processed. We were not able to examine data authorization controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

Data Retention controls are designed to ensure that data is retained according to federal and state guidelines. Our audit identified a significant weakness in the data retention for the UI tax application. *Audit Finding 1: ETA 581 Transaction Data Is Inaccessible For Audit*

AUDIT OBJECTIVES, SCOPE, AND METHODOLOGY

OBJECTIVES

Under the North Carolina General Statutes Chapter 147-64.6, the State Auditor is responsible for examining and evaluating the adequacy of operating and administrative procedures and practices, systems of accounting, and other elements of State agencies. This IS audit was designed to ascertain the effectiveness of application controls at the Employment Security Commission.

SCOPE

Application controls govern whether the design of the critical application control supports management's financial statement assertions and that the controls are functioning effectively. The scope of our IS application controls audit was to review application controls which directly affect the UI Tax application. Other IS access control topics were reviewed as considered necessary.

Scope Limitation: ESC could not provide the ETA 581 data during our audit. Therefore, we cannot determine if the transactions processed and represented in the ETA 581 report are complete, accurate, and or/valid.

METHODOLOGY

We audited policies and procedures, interviewed key administrators and other personnel, examined system configurations, tested on-line system controls, reviewed appropriate technical literature, and reviewed computer generated reports in our audit of application controls. Except as stated in the scope limitation paragraph above, we conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and *Information Systems Audit Standards* issued by the Information Systems Audit and Control Association.

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The North Carolina Employment Security Commission was created as the Unemployment Compensation Commission by the General Assembly in a special session on December 16, 1936. The name was changed by law to Employment Security Commission effective April 1, 1947. Originally established as a three-member body, it was changed to a seven-member commission effective July 1, 1941. The Commission's mission is to promote and sustain the economic well being of North Carolinians in the world marketplace by providing high quality and accessible workforce-related services. The Employment Security Commission is led by the chairman, two deputy chairmen, two deputy commissioners and three directors.

The Unemployment Insurance Tax System administers the Unemployment Insurance Tax which is a tax on employer payrolls paid by employers and used to provide funds from which unemployment benefits are paid to qualified unemployed worked. Unemployment tax is not deducted from employee wages.

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The following audit results reflect the areas where the Employment Security Commission, has performed satisfactorily and where recommendations have been made for improvement.

APPLICATION CONTROLS

Application reviews consist of determining whether the design of the critical application control supports management's financial statement assertions and that the controls are functioning effectively. These reviews are performed when the auditor intends to rely on an application system control to reduce the amount of substantive testing of details required before rendering an opinion on the financial statements.

DATA COMPLETENESS

Data completeness controls are designed to ensure that all transactions are entered into the system once and only once, that all errors are corrected without any being lost, duplicated or added, that all transactions are processed, that databases are updated completely, and that all output reports are complete. For the application reports examined, our audit did not identify significant weaknesses in completeness controls for the UI Tax application. We were not able to examine the data completeness controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

DATA ACCURACY

Data accuracy controls ensure that the details of transactions are entered and processed correctly, and that printed output is not distributed to the user until it is checked for reasonableness. For the application reports examined, our audit did not identify significant weaknesses in data accuracy controls for the UI Tax application. We were not able to examine the data accuracy controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

DATA VALIDITY

Data Validity ensures the data entered into the application is valid. Data is compared with the type of data that should be properly included in each input field, for example, only letters should be in a name field. In addition, a division of roles and responsibilities should exist, which should exclude the possibility for a single individual subverting a critical process. For the application reports examined, our audit did not identify significant weaknesses in the data validity for the UI Tax. We were not able to examine the data validity controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

DATA AUTHORIZATION

Controls are designed to ensure that access to data is appropriate and authorized and that access is granted on a need to know, need to use basis. The access control environment should consist of access control software and information security policies and procedures that are implemented appropriately to protect the application data. For the application reports examined, our audit did not identify weaknesses in data authorization for the UI Tax application. We were not able to examine the data authorization controls for the ETA 581 report due to the scope limitation mentioned in the scope paragraph of this report.

DATA RETENTION

Data Retention controls are designed to ensure that data is retained according to federal and state guidelines. Our audit identified a significant weakness in the data retention for the UI tax application.

AUDIT FINDING 1: ETA 581 TRANSACTION DATA IS INACCESSIBLE FOR AUDIT

The Employment Security Commission (ESC) is not retaining source transaction data in a manner where it is readily accessible for audit. Current retention methods would cause the Office of the State Auditor and/or ESC to incur significant cost to rebuild the data. In response to an audit request from the Office of the State Auditor, ESC disclosed that in order to provide such transaction data, approximately 448 backup tapes would have to be restored. ESC estimated that the loading of each tape to the mainframe would require approximately 30 minutes and the batch process would require approximately 90 minutes for each daily restore. ESC further disclosed that based on current billing rates for tape mounting and restoration of backups that our office and/or ESC would incur a $62,150.00 fee to recover transaction data to support the previous quarter's ETA 581 report. ESC also stated that additional programming would be necessary to utilize this information. ESC provided no estimate on the programming costs or the associated time for the development of such programs. To avoid retrieving this data from back-up tapes, our office also asked for ESC to retain the current data for a future ETA 581 report and provide the report and data to our office immediately after the report was produced. ESC failed to provide the Office of the State Auditor with this transaction data, but rather provided our office with instructions on how to recreate the ETA 581 report from back-up tapes. Because ESC does not retain the transaction data locally, an audit of the data could not be performed for the ETA 581 report.

*Recommendation***:** ESC should retain at least three years worth of transaction data on a local tera-station or another local storage device, so that the data supporting the ETA 581 report can be audited without costing both ESC and the Office of the State Auditor back-up tape fees. This would also ensure that ESC complies with the Department of Labor requirements.

Auditee's Response: While ESC does retain the data necessary for the replication of the ETA 581, we agree that the information is not available in a format that makes it easily auditable. ESC IS staff is currently reviewing the requirements for accomplishing this recommendation. The results will be provided to ESC senior management for consideration.

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