



STATE OF NORTH CAROLINA

DEPARTMENT OF ADMINISTRATION

FINANCIAL RELATED AUDIT

NOVEMBER 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

November 13, 2013

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Department of Administration
Bill Daughtride, Jr., Secretary
Speros Fleggas, Senior Deputy Secretary

This report presents the results of our financial related audit at the Department of Administration. 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 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 ways 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

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 Administration. 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 Department of Administration (Department) acts as the business manager for North Carolina state government and provides internal services and programs for state departments. The Department oversees operations such as building construction, purchasing and contracting for goods and services, managing state vehicles, acquiring and disposing of real property, and operating auxiliary services such as courier mail delivery and the sale of state and federal surplus property. The Department administers programs such as Indian affairs and veterans' affairs that provide advocacy, assistance, and services to diverse segments of the State's population.

AUDIT SCOPE AND OBJECTIVES

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

Our audit scope covered the period July 1, 2012 through December 31, 2012 and selected activities of the following organizational units:

Office of Fiscal Management - This organizational unit is responsible for the general accounting functions of the Department. The unit is responsible for filing timely reports, purchasing and issuing payment for goods and services, invoicing user agencies for central services, and recommending and administering fiscal policy within the Department. The activities of this unit are funded by state appropriations.

Division of Motor Fleet Management - This Division is a receipt-supported operation that purchases, maintains, assigns, and manages the State's centralized fleet of approximately 8,500 vehicles. The Division has an annual operating budget of approximately \$41 million.

Division of Surplus Property - The Division oversees and coordinates the disposal and sale of property no longer needed by state agencies and universities. The surplus property received is offered to other state agencies or is sold to qualifying non-profit organizations or the general public. The property is sold in the Division's Raleigh retail store or through an online bidding process. The Division has an annual operating budget of approximately \$1.8 million that is funded by service charges associated with the acquisition, receipt, warehousing, distribution, or transfer of any state surplus property, and the transfer or sale of recyclable materials.

Commission of Indian Affairs - The Commission was created by the North Carolina General Assembly for the purpose of bringing local, state, and federal resources together for the implementation or continuation of programs for the State's American Indian citizens. The Commission is also charged with promoting the recognition and rights of American Indians to pursue sacred cultural and religious traditions, providing aid and protection for American Indians when need is demonstrated, and assisting American Indian communities in social and economic development. The Commission has an annual operating budget of approximately \$4.3 million that is funded primarily by federal grants.

During our audit, we considered internal control in the organizational units listed above related to the following accounts/control objectives:

Motor Vehicle Repairs – Maintenance of the State's motor fleet includes vehicle repairs and maintenance, whether performed in-house at the Division's Raleigh facility or through independent service providers across the State. The Division incurred more

AUDIT SCOPE AND OBJECTIVES (CONCLUDED)

than \$2.3 million in vehicle repair and maintenance costs (excluding the Division's personal services costs) during our audit period. We examined the Division's procedures to safeguard the auto parts used at the state vehicle service facility in Raleigh. We also examined procedures to ensure the Division gets the best price when selecting service providers across the State to repair and maintain vehicles. We evaluated the design of internal control and performed further procedures on all these matters.

Surplus Property – The Division sold more than \$8.7 million in surplus property through their online bid process during our audit period. Approximately 94% of total surplus property sales occur through online bidding. We examined the Division's procedures to ensure the surplus property inventory is safeguarded and the goods are priced to maximize receipts for the State. We also examined procedures to ensure the Division collects the proper payment for the items sold, assesses an appropriate service fee, and remits the balance of the sale proceeds to the appropriate state agency. We evaluated the design of internal control over all these matters, but only performed detailed audit procedures on the safeguarding of property, pricing of online sale items, and the assessment of service fees.

HUD Section 8 Housing Program – The Commission of Indian Affairs receives funding from the U.S. Department of Housing and Urban Development to administer a housing program in counties with large American Indian populations. The program provided more than \$2 million in housing assistance during our audit period. We examined procedures to ensure payments are made only to applicants and property owners who are eligible for the program and that eligibility is reassessed each year as required by program rules. We evaluated the design of internal control and performed further procedures on all these matters.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the *Audit Scope and Objectives* section of this report and evaluated the design of the internal control. For certain objectives, 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 interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances, as considered necessary in the circumstances. 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: (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.

RESULTS AND CONCLUSIONS

The results of our audit disclosed deficiencies in internal control and 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. Management's responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them.

AUDIT FINDINGS AND RESPONSES

1. REVENUE FROM SALE OF SURPLUS PROPERTY NOT MAXIMIZED

The Department of Administration's (Department) online bidding process for selling surplus property does not guarantee the State receives the best possible price. As a result, the State is not maximizing revenues from surplus property sales. The Department's online surplus property sales exceeded \$12 million in fiscal year 2013.

The Department's Division of Surplus Property (Division) is responsible for selling the surplus property. The Division estimates the value of all property received and items valued at \$200 or greater are sold through an online bidding process. Less valuable items are sold in its retail store.

The Division's online bidding is a sealed bid process. Since bidders cannot see the bids of others, they cannot adjust their bids upwards in response to demand for an item. Also, under the sealed bid system, Division managers must meet to review the highest bids and decide which ones to reject because they are too low. There are hundreds of bids to review for each weekly sale.

We compared motor vehicles sold by the Division during our audit period to similar vehicles sold through the online auction site eBay. We found that vehicles sold on eBay received on average a 23% higher price than those sold through the Division's online bidding process. In fiscal year 2011, the Division performed a similar comparison of property sold. It found websites such as eBay bring 10% to 50% more in profit on similar items.

Recommendation: The Division should evaluate the cost effectiveness of either modernizing its bidding software or using an available third party auction site. Valuable employee time could be saved by an improved automated bidding process and revenues from surplus property sales could potentially increase.

Agency Response: Concur. The Division (Surplus Property) agrees that updating the surplus software to a live online bidding format similar to eBay will return 10% to 50% more profit for the state. To implement this recommendation, the Department will need to retain the services of an IT consultant to perform an evaluation of options, including third party auction sites and, based on the recommendations of the study, work with Surplus Property, DOA Management Information Systems, and ITS to develop a Request for Proposals (RFP) for modernizing of Surplus Property's bidding software. SSP anticipates awarding this RFP in the spring of 2014. The Department's Chief Operating Officer and Chief Financial Officer are responsible for ensuring that these actions are implemented within the timeframes specified.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

2. ENHANCEMENTS NEEDED IN SECURITY OF SURPLUS PROPERTY INVENTORY

The Department of Administration's Division of Surplus Property (Division) needs to enhance security of the surplus property inventory it holds. Division staff estimates that the warehouse and store has approximately \$435,000 in inventory at any given time. However, the exact value is unknown because property is valued when sold and not when it is received.

Physical Security of the Inventory Should Be Enhanced

Due to the sensitive nature of this matter, we have conveyed details to management in a separate communication.

Access to the System and Inventory Not Adequately Segregated

We identified one employee with physical access to the property also has system access rights to create and edit property records and access to create, edit, and delete bid and sales data in the surplus property system. The employee could take property and delete it from the records, thus covering up the theft.

We determined during our audit that a report identifying all deleted property records is generated from the system and reviewed monthly. However, the report is reviewed by the same person who has access to delete records from the system and who has physical access to the property. We inspected a report that identified all deletions made to the inventory records during July 2012 to December 2012. We found only two deletions by the employee and both were deemed reasonable and appropriate.

Recommendation: The Division should consider making improvements to the physical security of the inventory. The Division should ensure that employees with system access do not also have access to physical property or should implement adequate monitoring controls to review edits to system records. The monitoring of such edits should be performed by someone other than those making the edits.

Agency Response: Concur. The Division (Surplus Property) agrees that security is very important and has been a continuous and ongoing project for the Division. Many of the security recommendations conveyed by the State Auditor have been implemented and the final phase of security enhancements will be completed by spring of 2014.

The second part of this recommendation to implement monitoring controls of system edits has been completed. Surplus Property Policy has been amended placing the final review authority of deleted property in the hands of the Director, Surplus Property. Going forward, a report of system edits will be given to the Division Director on a monthly basis.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Department's Chief Operating Officer and Chief Financial Officer are responsible for ensuring that these actions are implemented within the timeframes specified.

3. STATE VEHICLE REPAIRS AND MAINTENANCE COSTS NOT ADEQUATELY MONITORED

The State is at risk of incurring unreasonable and unnecessary repair and maintenance costs for motor vehicles. The Department of Administration's Motor Fleet Management Division (Division) approves all service requests performed by outside service providers but only requires supervisory review of the decisions if the expected cost is \$1,000 or more. The Division typically spends more than \$5 million with service providers for repairs and/or maintenance of state vehicles in a fiscal year, of which approximately \$3.8 million is for repairs of less than \$1,000 per service.

Repairs and maintenance on state vehicles located in the Raleigh area are typically performed by Division mechanics at the Division's repair shop. However, repairs and maintenance for state vehicles not located in the Raleigh area are typically performed by private shops and auto dealerships.

All repairs by service providers must be approved by a Division mechanic. The Division requires an additional supervisory review and approval for individual service requests more than \$1,000. There are no reviews or monitoring procedures in place for requests of less than \$1,000 to ensure that the smaller repair/maintenance decisions are reasonable and consistent.

Without monitoring at least a sample of the decisions, unnecessary services or unreasonable rates could be approved and would not be detected by management. However, our tests did not identify any instances in which unnecessary services or unreasonable rates were approved.

Recommendation: The Division should implement monitoring procedures for service requests less than \$1,000. While the review of every request of less than \$1,000 is not practical, management could develop a plan to review a sample of requests on a regular basis to ensure services and costs approved by employees are reasonable.

Agency Response: Concur. The Division (Motor Fleet) will have the Division's Accounting Department randomly pull ten (10) daily invoices to review. These invoices will be provided to the Division's Commercial Accounts Manager to compare to the All Data Estimating System used by Motor Fleet's Authorization Agents to ensure that only necessary services and/or reasonable rates are being approved by MFM. This procedure, which has already been implemented, will check approximately 5% to 10% of the daily invoices.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

4. MOTOR FLEET PARTS INVENTORY VULNERABLE TO THEFT

The Department of Administration's Motor Fleet Management Division (Division) has granted system access rights that would allow employees to take auto parts from inventory and delete them from the records, thus covering up the theft. The Division typically purchases more than \$400,000 of auto parts in a fiscal year.

The Motor Fleet Management System (system) is used to account for auto parts purchased and used, as well as to track vehicle repairs. We noted that all employees with physical access to auto parts also have system access rights to add to, delete from, or adjust auto parts records. Further, the Division does not monitor entries in the system to identify unusual activity.

We determined that a report identifying all changes made to the inventory records can be generated from the system, but management does not review this report regularly. We reviewed a report that identified all 33 changes (totaling \$7,965) made to the inventory records during our audit period and noted no significant changes made by employees with access to both the system and the auto parts.

Recommendation: The Division should ensure that employees with system access do not also have access to the parts inventory or should implement adequate monitoring controls to review edits made to system records.

Agency Response: Concur. The Division (Motor Fleet) will reduce the number of authorized employees who can access the parts adjustment portion of their system. All adjustments will be made by the Parts Supervisor with the approval of the Fleet Manager.

A special character will be used in the adjustment process known only by the Supervisor, Manager and Director of MFM. The modifications to the system have been implemented.

MFM will work the DOA's Management Information System team to develop a daily report that can confirm the part used was applicable for that particular vehicle. This feature of MFM's system is expected to be operational by December 1, 2013.

MFM has already restricted the Mechanic's from entering the parts area unless they are given permission to retrieve a Special Tool housed in the Parts Department or escorted to match a particular part that may be in stock.

The Department's Chief Operating Officer and Chief Financial Officer are responsible for ensuring that these actions are implemented within the timeframes specified.

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ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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This audit required 657 audit hours at a cost of \$49,932.