



STATE OF NORTH CAROLINA

**DEPARTMENT OF JUSTICE
FINANCIAL RELATED AUDIT**

JUNE 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF JUSTICE

FINANCIAL RELATED AUDIT

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ADMINISTRATIVE OFFICER

THE HONORABLE ROY A. COOPER, III, ATTORNEY GENERAL



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AUDITOR'S TRANSMITTAL

June 21, 2012

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
The Honorable Roy A. Cooper, III, Attorney General

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

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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 Justice. The Office of the State Auditor initiated this audit to follow-up on the recommendations made in the November 2010 performance audit report and to improve state contract monitoring practices for service contracts.

The General Assembly enacted Session Law 2010-194 in October 2010 in order to “enhance the efficiency and effectiveness of the contracts process.” This legislation increased the authority of the Secretary of the Department of Administration and required the Attorney General to review certain contracts in order to improve contract monitoring and enforcement. The Joint Legislative Program Evaluation Oversight Committee recommended the legislation following the release of three performance audits by the State Auditor identifying significant deficiencies in statewide contracting practices:

- July 2008 – *Department of Health and Human Services – Division of Medical Assistance – Oversight of the Mental Health Services Utilization Review Contract*;
- September 2008 - *Department Supplies Term Contract Administered by the Division of Purchase & Contract – Department of Administration*;
- April 2009 - *State Health Plan FY 2008, Projected Versus Actual Results*.

Session Law 2010-194 only applied to statewide and agency term contracts. There were no additional requirements imposed upon service contracts.

The State Auditor issued another report in November 2010, “*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices*,” making recommendations that would improve the quality of contracts awarded by the State and protect the interests of North Carolina. Specifically, the State Auditor recommended that contract terms include:

- Written contract close-out procedures to ensure that vendors have fulfilled all obligations and the State has received the benefits for which it contracted;
- Contract administration plans in order to improve contract monitoring by documenting specifics about expected contractor performance and how the agency will evaluate and assess performance for the service contract;
- Detailed statements of work to use in properly monitoring vendor performance or holding the vendor legally accountable for nonperformance;
- Performance measures that improve contract monitoring by having the vendor provide regular programmatic reports and payments linked directly to the vendor’s performance;
- Right to audit clauses that give state agencies the right to access and audit vendor records in order to properly monitor and verify vendor performance as well as enable agencies to identify overcharges or unallowable costs charged by the vendor.

BACKGROUND AND GENERAL OBJECTIVES

Six months later, the General Assembly made a “technical correction” to the legislation noted above and required the Attorney General to “review all proposed contracts for supplies, materials, printing, equipment, and contractual services that exceed one million dollars (\$1,000,000) to ensure that the proposed contracts...accomplish the intended purposes of the proposed contract.”

Effective July 1, 2011, *North Carolina General Statute 114-8.3* requires the Attorney General to review statewide and agency term contracts as well as all service contracts to ensure they contain the necessary terms and conditions that allow for improved contract monitoring.

GENERAL OBJECTIVES

The general objectives of a financial related audit may include determining whether:

- The organization has complied with finance-related laws, regulations, and provisions of contracts or grant agreements;
- Assets have been safeguarded;
- Financial resources have been prudently managed;
- Improvements are 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.

SCOPE AND SPECIFIC OBJECTIVES

Our audit scope included a review of the Department's policies, procedures, and processes over service contract reviews conducted specifically in accordance with G.S. 114-8.3 for the period July 1, 2011, to February 29, 2012. The scope specifically excluded contracts for the purchase of goods and commodities. The scope also excluded personal service contracts which are contracts for temporary employees. We conducted the fieldwork from December 2011 to May 2012.

The specific audit objective was to determine if the Department had implemented a system of control over the contract review process that would provide reasonable assurance that all proposed state contracts had been approved in accordance with G.S. 114-8.3.

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 records, and examining documentation supporting controls.

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.

To determine if the Department's guidance for contract reviews allowed for a quality review of contracts to ensure they will "accomplish the intended purposes of the proposed contracts," we reviewed the contract review checklist the Department provided to reviewing attorneys and the recommendations made by the State Auditor in the November 2010 performance audit.

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

State agencies spend, on average, approximately \$242 million per month on contracted services. However, the Department's system of controls over the service contract review process does not provide reasonable assurance that all contracts over \$1 million have been reviewed in accordance with G.S. 114-8.3. These items are described in the Audit Findings and Responses section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

1. CONTRACT REVIEW PROCESS IS POORLY DESIGNED

The Department of Justice's (Department) contract review process is not designed to provide reasonable assurance of the Department's compliance with statutory requirements to review all supply, material, printing, equipment, and contractual services contracts over \$1 million. General Statutes charge all state managers with the responsibility for providing reasonable assurance regarding compliance with state law.¹

The Department believes that its system for reviewing contractual services contracts is sufficient. We do not agree. The State spends billions of dollars on contractual services each year. Without a sufficient system in place, it is impossible to know the value of service contracts properly reviewed or how much in service contracts were not reviewed.

Department Unable to Identify Contracts Subject to Review and Contracts Reviewed

The Department's contractual services review system does not provide reasonable assurance that the Department will review all state proposed contractual services contracts over \$1 million as described by G.S. 114-8.3. Specifically, the Department's system does not identify contractual services contracts that should be reviewed and cannot readily identify all contracts that it did review.

When auditors requested a listing of all service contracts over \$1 million that should be reviewed, the Department stated that it does maintain such a listing and that the Department does not try to identify all service contracts needing review. Instead, the Department said that it relies on state agencies to comply with the statute² and submit all contracts over \$1 million to the Department for review. The Department further stated that the statute does not require the Department to identify, or maintain a listing of, contracts subject to review. The Department said it was unaware if such a listing was maintained anywhere in state government.

Also, the Department cannot readily identify all contracts that were reviewed by the Department.

For example, auditors had to make several inquiries in order to determine if a \$3.15 million service contract approved by the Department of Administration (DOA) had been reviewed in accordance with G.S. 114-8.3:

1. The Department attorney designated as the audit liaison for this audit did not know if the contract had been reviewed.
2. There was no evidence of any Department contract review found in DOA's contract file.

¹ NC General Statute 143D

² NC General Statute 143-52.2

AUDIT FINDINGS AND RECOMMENDATIONS

3. DOA's State Purchasing Officer was not aware if the contract had been reviewed by the Department.
4. DOA's in-house legal counsel was not aware if the Department had reviewed the contract.
5. Finally, auditors contacted a Department attorney who confirmed, and provided evidence to support, that a contract review was completed. However, the attorney did not have guidance on how to complete the review in accordance with G.S. 114-8.3 at the time the review was performed (see finding 2 below).

The Department confirmed that to get a listing of all contracts that were reviewed, auditors would have to question all 260 plus attorneys employed by the Department.

Agencies Are Not Sure Which Contracts to Submit for Review

A survey of contract managers at various state agencies indicated that contract managers do not understand which contracts should be reviewed.

- Two of 35 contract managers (6%) stated they were not aware of the requirement to submit proposed contracts over \$1 million to the Department for review;
- Three of 35 contract managers (9%) stated the types of contracts they had awarded were not subject to review pursuant to G.S. 114-8.3, based on their interpretation of a different state law.³ However, a Department attorney confirmed that the contract managers had misinterpreted the General Statute and are required by law⁴ to submit the contracts to the Department for review.

As an example of these misunderstanding, the Department of Environment and Natural Resources (DENR) reported that it did not submit six contracts, each more than \$1 million, to the Department because DENR contract managers did not know about the requirement.

Department is Required by Law to Provide Assurance of Compliance

The Department should have a contract review system that provides reasonable assurance that the Department has reviewed all state proposed contracts over \$1 million as described by G.S. 114-8.3 for two reasons: (1) state law requires it and (2) it is a best practice according to the Government Accountability Office (GAO).

First, the Department should have a system in place designed to ensure all proposed contracts over \$1 million are reviewed because state law requires it. The State Government Accountability and Internal Control Act⁵ says, "The management of each State agency bears

³NC General Statute 136-28.1(a)

⁴NC General Statute 136-28.1(h)

⁵NC General Statute 143D

AUDIT FINDINGS AND RECOMMENDATIONS

full responsibility for establishing and maintaining a proper system of internal control within that agency.” The Act further defines internal control as “An integral process...designed to provide reasonable assurance regarding...compliance with applicable laws and regulations.”

Designing a system to achieve compliance with law is also a best practice according to the GAO. The GAO states that agency managers have a fundamental responsibility to implement systems that are designed to achieve compliance with applicable laws and regulations.⁶ The GAO further states that agency management is responsible for planning, organizing, directing, and controlling program operations. Additionally, agency management should include systems for reporting and monitoring program performance.⁷

Because the Department cannot identify or confirm all service contracts it is required to review pursuant to G.S. 114-8.3, the Department cannot properly plan, organize, direct and control the review process. Furthermore, the Department is not able to report and monitor the results of its service contract review process because it is not able to readily identify all contracts that have been reviewed. As a result, the Department’s review process is unable to provide reasonable assurance to management that the Department complies with the statute as required by The State Government Accountability and Internal Control Act.

Department Believes it is Not Statutorily Charged with Certain Responsibilities

The Department does not have a system designed to achieve reasonable assurance of compliance with G.S. 114-8.3 because it believes that this statute does not charge the Department with certain responsibilities. For example, the Department does not believe it is required by statute to identify all contracts that require a review, identify all contracts that the Department has reviewed, and develop rules for state agencies to submit contracts to the Department for review.

Although statute requires the Department to review all contracts over \$1 million, the Department does not believe it has the responsibility, nor is it the appropriate agency, for determining all service contracts it is required to review. Instead, the Department relies on state agencies to comply with G.S. 143-52.2 and submit all contracts over \$1 million to the Department for review. However, as noted above, not all state agencies are aware of the requirement to submit all contracts over \$1 million to the Department for review and some eligible contracts were not submitted for review.

The Department also believes that the General Statute does not assign it the responsibility to demonstrate that all contracts that required a review in accordance with G.S. 114-8.3 were actually reviewed by the Attorney General or his designee. The Department has not developed procedures to track and monitor the review process nor assigned a unit or individual the responsibility to track contract reviews.

⁶United States Government Accountability Office, Government Auditing Standards, Chapter A1.08(c), July 2007.

⁷United States Government Accountability Office, Government Auditing Standards, Chapter 7.15(c), July 2007.

AUDIT FINDINGS AND RECOMMENDATIONS

The Department also states that G.S. 143-49(12) assigns the responsibility to the Department of Administration, not to the Attorney General, to develop the rules, regulations and procedures for agencies to submit contracts to it for review. Conversely, the Department of Administration interprets the statute to assign this responsibility to the Attorney General. As a result, no rules have been developed since the legislation initially became effective on October 1, 2010, about 20 months ago.⁸

Risk that All Significant Contracts are not Reviewed

Without a system in place to achieve compliance with G.S. 114-8.3, there is a risk that service contracts will be awarded without having a review by the Attorney General or his designee. The North Carolina Accounting System indicates that state agencies spent approximately \$1.9 billion on purchased services in the first nine months of fiscal year 2012.⁹ However, it is unknown how many dollars are related to contracts over \$1 million.

Because of the Department's poorly designed system, the General Assembly has no assurance that their goal to enhance the efficiency and effectiveness of the contracts process will be achieved.

Recommendation:

The General Assembly should assign the responsibility of accumulating and maintaining a master listing of contracts subject to review under G.S. 114-8.3 to a specific agency.

The Department should develop policies and procedures that will enable the Department to readily identify all contracts reviewed by the Attorney General or his designee pursuant to G.S. 114-8.3.

The Department should develop procedures to match all contracts it reviews under G.S. 114-8.3 with the master listing and follow-up on any unmatched contracts.

The Department should work in consultation with the Department of Administration to develop procedures that would provide for the orderly and efficient submission of all proposed contracts over \$1 million to the Department for review.

The Department should assign an individual the responsibility of monitoring the Department's performance in complying with G.S. 114-8.3 and report those results on a regular basis.

⁸The inclusion of contractual services contracts was not effective until July 1, 2012.

⁹Source: NCAS Statewide Accounting System – Statewide expenditures excluding the University System, for Purchased Services, less line items for travel, utility and energy services, and communication and data processing services.

AUDIT FINDINGS AND RECOMMENDATIONS

2. NO WRITTEN GUIDANCE PROVIDED FOR CONTRACT REVIEWS

After the initiation of this audit, the Department of Justice (Department) provided final written guidance to its attorneys for reviewing contracts pursuant to G.S. 114-8.3. Originally, the Department indicated in a November 19, 2010 memo to the General Assembly's Program Evaluation Division that it intended to finalize this guidance by December 31, 2010. As a result, Department attorneys were conducting contract reviews for 16 months without written guidance.¹⁰

Written Guidance Not Provided in Timely Manner

Until auditors raised the issue, the Department had not provided written guidance to Department attorneys that would ensure consistent and quality reviews were performed on contracts over \$1 million in accordance with G.S. 114-8.3. The Department has since approved a consolidated contract review checklist to be used by its attorneys effective February 22, 2012.

The checklist guides attorneys to review proposed contracts for legal enforceability as well as for certain deficiencies that were noted in the State Auditor's November 2010 performance audit "*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices*." For example, the checklist recommends attorneys review service contracts for:

- Contract close-out procedures
- Contract administration plans
- Detailed statements of work
- Performance measures
- Right to audit clauses

In order to more effectively and efficiently comply with statute, the Department has initiated discussions with the Governor's Department of General Counsel to delegate certain levels of contract reviews to state agency in-house legal counsel, as allowed by law.

Consistent and Quality Contract Reviews Improve Contracting Practices

The Department should have provided written guidance to its attorneys for reviewing contracts over \$1 million in accordance with G.S. 114-8.3 to address the multiple deficiencies in contracting practices previously reported by the State Auditor.

The State Auditor made recommendations in a November 2010 performance audit report "*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices*" to improve the quality of contracts statewide and protect the interests of North Carolina. The State Auditor recommended that contracts and contract files contain:

- Written contract close-out procedures to ensure that vendors have fulfilled all obligations and the State has received the benefits for which it contracted;

¹⁰The inclusion of contractual services contracts was not effective until July 1, 2012.

AUDIT FINDINGS AND RECOMMENDATIONS

- Contract administration plans in order to improve contract monitoring by documenting specifics about expected contractor performance and how the agency will evaluate and assess performance for the service contract;
- Detailed statements of work to use in properly monitoring vendor performance or holding the vendor legally accountable for nonperformance;
- Right to audit clauses that give state agencies the right to access and audit vendor records in order to properly monitor and verify vendor performance as well as enable agencies to identify overcharges or unallowable costs charged by the vendor.

Poor Contracting Practices May Continue

Because the Department did not provide written guidance to its staff to use when reviewing contracts over \$1 million, there is no assurance consistent and quality reviews contract reviews were completed prior to February 2012.

Consistent and quality contract reviews help to reduce the risk that state agencies would continue to award contracts that do not include terms and conditions that form the basis for effective contract monitoring and enforcement.

The state spends a significant amount of money on service contracts. An auditor review of the North Carolina Accounting System data indicates that state agencies spent approximately \$1.9 billion on purchased services in the first nine months of fiscal year 2012.¹¹ However, it is unknown how many dollars are related to contracts over \$1 million.

Recommendation:

The Department should ensure that all attorneys delegated the responsibility of conducting contract review in accordance with G.S. 114-8.3 are provide written guidance to ensure that consistent and quality reviews are performed in accordance with G.S. 114-8.3.

The Department should work in consultation with the Department of Administration to ensure that its written guidance for reviewing contracts is comprehensive from both a legal and procurement point of view.

The Department should develop policies and procedures for monitoring contract reviews to ensure all attorneys conduct their analysis based on the written guidance provided by the Department.

¹¹Source: NCAS Statewide Accounting System – Statewide expenditures, excluding the University System, for Purchased Services, less line items for travel, utility and energy services, and communication and data processing services.

APPENDIX

Auditor's Response

It is the intent of the Office of the State Auditor (OSA) that the Governor, the General Assembly, and the citizens of North Carolina receive only complete and accurate information from the reports issued by this office. Therefore, we are required to provide additional explanation when an agency's response could potentially cloud an issue, mislead the reader, or inappropriately minimize the importance of our findings.

Additionally, Generally Accepted Government Auditing Standards state,

When the audited entity's comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditor's recommendations, the auditors should evaluate the validity of the audited entity's comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement.

To ensure the availability of complete and accurate information and in accordance with Generally Accepted Government Auditing Standards, we offer the following clarification.

The Department of Justice's (Department) response misleads the reader by implying that our objective was to identify instances where an appropriate legal review was not performed. Our audit objective was to review the Department's system (process) to see if it provided reasonable assurance that all contracts over \$1 million were reviewed. We believe that we provided ample evidence that the Department's process is not designed to provide that assurance.

The General Assembly assigned the responsibility of reviewing all proposed contracts of more than \$1 million to the Department. Those reviews are now a specific legal responsibility of the Department.

The reason the General Assembly assigned this responsibility to the Department is because there is a history of poorly written contracts between state agencies and service providers. The Office of the State Auditor released the following reports highlighting poorly written contracts:

- July 2008 – *Department of Health and Human Services – Division of Medical Assistance – Oversight of the Mental Health Services Utilization Review Contract;*
- September 2008 - *Department Supplies Term Contract Administered by the Division of Purchase & Contract – Department of Administration;*
- April 2009 - *State Health Plan FY 2008, Projected Versus Actual Results, and;*
- November 2010 – *Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices.*

In order to meet its assigned legal responsibility, and as stated in our report, the Department should have internal control (procedures) in place to provide reasonable assurance that it is reviewing all proposed contracts over \$1 million. To do so, Department management should at

least be aware of all proposed contracts exceeding \$1 million, which contracts it was formally asked to review, which contracts it did review, and the results of those reviews. Furthermore, managers should monitor the quality of at least a sample of the reviews and report the results.

The Department misleads the reader by asserting that it complies with Government Accountability Office (GAO) best practices. However, the Department provided no evidence that it follows the GAO best practices cited in our report. In fact, the Department's statement that attorneys "have been reviewing contracts at the request of state agencies long before this statutory requirement was put in place" implies that little has changed since the General Assembly assigned this legal responsibility.

The Department also responded that "the audit finding incorrectly expands the law's requirements and places responsibility on the DOJ..." to identify agencies contemplating contracts.

The Department is incorrect.

While we agree that such a list should be maintained, we did not say that the Department should maintain the list. As noted in the report, our recommendation is that the General Assembly assign the responsibility of accumulating and maintaining a master list of contracts subject to review to a specific state agency.

The Department contends that its passive approach of simply relying on its staff of attorneys' knowledge of contract law to review contracts brought to their attention is sufficient. However, this is the same passive approach that did not prevent the poorly written contracts noted above.

The Department made other statements in its response that were unrelated to the audit objective or results. Auditors did not review Department financial transactions because that was not an audit objective. Likewise, nowhere in our report did we suggest that the Department was responsible for monitoring compliance of other state agencies. By commenting on those issues, the Department clouds the real issue and misleads the reader.

The Governor, Legislators, and the citizens of North Carolina should consider the clarification provided above when using this report to evaluate the Departments review of proposed contracts for more than \$1 million and holding government managers accountable for their programs.

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State of North Carolina

Department of Justice
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ROY COOPER
ATTORNEY GENERAL

June 8, 2012

The Honorable Beth A. Wood, CPA, Auditor
State of North Carolina
2 South Salisbury Street
Raleigh, North Carolina 27601

Dear Ms. Wood:

We thank you for the opportunity to provide a written response to your transmittal letter dated May 30, 2012 in regards to the financial related audit of our Department's contract review process that you currently are in the process of wrapping up.

We also appreciate the time and efforts of your staff and yourself to meet with us personally in the last couple of weeks to help us better understand the basis of your findings to enable us to provide you with an informed response as provided below.

Attached, please also see a signed copy of the Management representation letter that you had requested to submit to you as well.

We would like to thank you once again for the opportunity to present this response. Please contact me if you have any questions or concerns about the audit response.

Sincerely,

A handwritten signature in blue ink, appearing to read "Grayson Kelley".

Grayson Kelley
Chief Deputy Attorney General

Enclosures

cc: Roy Cooper
Attorney General

William S. Styres, CPM
Audit Manager

Response to Findings Listed in the Auditor's Letter Dated May 30, 2012

1. "Contract Review Process is Poorly Designed"

The Department of Justice (the DOJ) strongly disagrees with the Office of State Auditor's incorrect interpretation of N.C.G.S. 114-8.3 and N.C.G.S. 143D, the State Governmental Accountability and Internal Control Act.

N.C.G.S. 114-8.3 requires the DOJ to "...review all proposed contracts...that exceed one million dollars \$1,000,000..." The Office of State Auditor (the Auditor) has provided no evidence that any contract during the audit period failed to receive an appropriate legal review. In fact, the DOJ has competent, licensed attorneys who are well versed and trained in contract law and have been reviewing state contracts for years.

The Auditor has incorrectly interpreted the law to require the Department to "identify contracts subject to review..." The audit finding incorrectly expands the law's requirements and places responsibility on the DOJ which has no way of identifying which state agencies and divisions are contemplating contracts, or even that such contracts exist. The DOJ attorneys must therefore rely on state agencies to submit these contracts for review.

Similarly, the conclusion that some contract managers within other state agencies were unaware of their responsibility under the law should result in an audit finding for the individual agency for non-compliance with N.C.G.S. 143-52.2, not the DOJ. N.C.G.S. 143-52.2 reads: "The Secretary of Administration and every department, agency and institution of the State shall submit all proposed contracts for supplies, materials, printing, equipment and contractual services that exceed one million (\$1,000,000) to the Attorney General or the Attorney General's designee for review as provided in G.S. 114-8.3(a)."

The DOJ is aware of and complies with its responsibility to maintain a proper system of internal controls for our financial operations. However, the law does not require the DOJ to purchase, maintain or establish systems or programs to monitor statewide compliance of *other* agencies and report on how well *they* comply with statutes applicable to them as described in N.C.G.S. 143-52.2.

The DOJ complies with GAO Best Practices in implementing systems which are designed to achieve compliance with applicable laws, and provides its lawyers with appropriate systems and equipment, adequate training, law research assistance and programs and internal procedures to help them carry out their daily responsibilities to perform a review of any contract that falls under N.C.G.S. 114-8.3(a). In fact, attorneys

with the DOJ have been reviewing contracts at the request of state agencies long before this statutory requirement was put in place.

Furthermore, the audit's assertion that the DOJ is not in compliance with N.C.G.S. 143D is another incorrect interpretation of state law. The primary purpose of that statute is to ensure that state agencies have rigorous internal controls over their financial portfolios and associated financial statement records. At no time during the audit process, did the audit team review the DOJ specific financial transactions or financial statements associated with the primary purpose of N.C.G.S. 143D. The secondary purpose of N.C.G.S. 143D is to ensure that we have systems that help us comply with applicable laws and regulations, and as stated in our response in the above paragraphs, there is no evidence that the DOJ has been non-compliant with N.C.G.S. 114-8.3 or has not provided adequate systems to our attorneys to help them review the contracts that come to us under N.C.G.S. 114-8.3.

The Auditor "requested a listing of all service contracts over \$1,000,000 that should be reviewed." This finding seems to conclude that since the DOJ cannot show the auditors a contract list that tracks all contracts that need to come to us for review, we are non-compliant with N.C.G.S. 143D. However, in a meeting held recently, the auditors themselves agreed that the Department of Administration is in a better position to maintain and track statewide contracts with such a list, as they administer and control all contracts statewide. The absence of such a list should not be cited as a non-compliance issue for the DOJ.

In summary, the main thrust of this audit finding suggests that there should be a centralized list of draft contracts in excess of one million (\$1,000,000). Such a list may be a useful tool for auditors or others reviewing contracted goods and services. However, it is our understanding that no such list is maintained by any agency, much less the DOJ. If such a list is to be maintained, the DOJ would support its creation and funding within the Department of Administration, which has a more intimate knowledge of the status of state agency contracts.

2. "No Written Guidance Provided to Contract Review"

Written guidance for contract reviews under the new statute was finalized in February of 2012 by DOJ senior management and distributed to the appropriate attorneys.

The written guidance was not finalized earlier because the Legislature amended the law effective June 27, 2011, which changed the definition of the types of contracts that are to be reviewed. Up until February of 2012 and for many years preceding the enactment of the law, contract review activities were conducted by competent licensed attorneys who are required to adhere to strict ethics guidelines, continuing legal training and policies to maintain their licenses in good standing. The quality of the legal advice given to state agencies regarding contracts is not solely dependent

on a checklist. However, we concur that the written guidance will assist attorneys in contract reviews.

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