

STATE OF NORTH CAROLINA

**DEPARTMENT OF ADMINISTRATION
DIVISION OF PURCHASE AND CONTRACT
FINANCIAL RELATED AUDIT**

JUNE 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

DEPARTMENT OF ADMINISTRATION

DIVISION OF PURCHASE AND CONTRACT

FINANCIAL RELATED AUDIT

JUNE 2012

ADMINISTRATIVE OFFICER

MOSES CAREY, JR., SECRETARY



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AUDITOR'S TRANSMITTAL

June 21, 2012

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
Moses Carey, Jr., Secretary

This report presents the results of our financial related audit at the Department of Administration, Division of Purchase and Contract. 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 Recommendations 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 Administration, Division of Purchase and Contract. 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.*

The State Auditor issued another report in November 2010, “*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices,*” making recommendations to improve service contract monitoring practices and protect the interests of North Carolina. Specifically, the State Auditor recommended that the Division of Purchase and Contract should provide written guidance to state agencies on:

- Contract monitoring training;
- Maintaining contract files;
- Contract monitoring practices;
- Contract closeout procedures;
- Post-contract review procedures;
- Necessary planning for effective 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.

BACKGROUND AND GENERAL OBJECTIVES

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 of Administration, Division of Purchase and Contract's (Division) implementation of the State Auditor's recommendations made in the November 2010 performance audit report and the General Assembly's directives in Session Law 2010-104. Our scope included the Division's implementation efforts for the period October 1, 2010, to February 29, 2012. We conducted the fieldwork from December 2011 to May 2012.

The specific audit objectives were to determine if the Division had implemented (1) the recommendations made by the State Auditor in the November 2010 performance audit "Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices" and (2) directives of the General Assembly as stated in Session Law 2010-194 and G.S. 143-49.

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.

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 Division has not fully implemented the State Auditor's recommendations from the November 2010 performance audit, "*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices,*" or the directives of the General Assembly as written into Session Law 2010-194 and North Carolina General Statute 143-49 to improve service contract monitoring practices and protect the interests of North Carolina. These items are described in the Audit Findings and Recommendations section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

NO WRITTEN GUIDANCE AND TRAINING PROVIDED TO STATE AGENCIES

The Department of Administration, Division of Purchase and Contracts (Division) has not fully implemented recommendations from the performance audit “*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices*” issued by the State Auditor in November 2010. Additionally, the Division has not fully enforced certain authority and responsibilities it was granted by the General Assembly in Session Law 2010-194. As a result, it is likely that state agencies continue to use poor service contract monitoring practices noted in the November 2010 audit. At risk is approximately \$2.9 billion state agencies spend annually on purchased services.¹

State Auditor’s Recommendations Not Fully Implemented

The Division has not fully implemented recommendations from the State Auditor’s November 2010 performance audit “*Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices.*” Specifically, the Division has not provided final written guidance to state agencies for effective service contract monitoring practices.

The Division distributed draft guidance for contract monitoring practices to pilot agencies for testing and feedback. In March 2011, the pilot agencies indicated to the Division that more clarity and direction should be incorporated into the written guidance. Due primarily to the vacancy in a project manager position, the Division did not begin redrafting written guidance for service contract monitoring practices until eight months later in December 2011.

The Division established a workgroup comprised of procurement personnel from various agencies and plans to have final written guidance available by December 31, 2012. Additionally, the Division plans to provide classroom training to procurement personnel on this new guidance in January through April 2013.

In the November 2010 audit, the State Auditor recommended that the Division provide written guidance to state agencies on:

- Contract monitoring training;
- Maintaining contract files;
- Contract monitoring practices;
- Contract close-out procedures;
- Post review procedures; and
- Necessary planning for effective contract monitoring.

¹ Source: NCAS Statewide Accounting System – Statewide expenditures for Purchased Services, less line items for travel, utility and energy services, and communication and data processing services for the year ended June 30, 2011. The Division is not responsible for establishing rules for information technology (IT) services. The amount of non-IT related contracts can not be readily determined.

AUDIT FINDINGS AND RECOMMENDATIONS

Additionally, effective October 1, 2010, Session Law 2010-194 directed the Secretary of Administration to develop final written guidance and procedures to state departments, agencies, and institutions for contract monitoring and enforcement.

The Government Accountability Office states that government agencies should “include policies and procedures for ensuring that the findings of audits and other reviews are promptly resolved.”² Although neither the State Auditor nor Session Law 2010-194 established a timeline for the Division to provide final written guidance for service contract monitoring practices to state agencies, 26 months does not appear to be a reasonably prompt time frame.

Legislative Mandates Not Fully Implemented

The Division has not developed final written guidance and procedures to state agencies that would allow for the orderly and efficient submission of proposed state contracts over \$1 million to the Department of Justice for the Attorney General’s legislatively required review. As of February 29, 2012, auditor inquiry with the Department of Justice indicates there has been no consultation between the two departments to develop these procedures.

Although no final guidance has been developed, the Division notified state agencies of the requirement to submit contracts over \$1 million to the Attorney General for review. On November 17, 2010, the Division issued a memo to all state purchasing officers stating the new statute required all contracts over \$1 million to be submitted to the Attorney General, or his designee, for review. The memo further states the Attorney General would be issuing guidance on how these contracts should be submitted for review.

Also, the Division has not developed final position descriptions, career paths, or training programs that align with procurement related positions. The Division plans to have position descriptions for state procurement professionals submitted to and approved by the Office of State Personnel by December 31, 2012. The Division also states there will be a pilot training for purchasing agent level procurement personnel by December 31, 2012.

Additionally, the Division has not finalized a contract management certification program for state employees, nor is there an established timeline for the certification program to be fully implemented. The Division states it must have the final position descriptions, career paths, and training programs noted above before a contract management certification program can be developed.

General Assembly Mandates

Session Law 2010-194 increased the authority and responsibilities of the Secretary of Administration “to provide oversight of the review and award of contracts and to enhance the efficiency and effectiveness of the contracts process.” The legislation resulted from recommendations made by the Joint Legislative Program Evaluation Oversight Committee

² GAO Standards for Internal Control in the Federal Government. Pgs. 20-21.

AUDIT FINDINGS AND RECOMMENDATIONS

following the release of three performance audits by the State Auditor in 2008 and 2009 identifying significant deficiencies in statewide contracting practices.

Specifically, effective October 1, 2010, Session Law 2010-194 directed the Secretary of Administration to:

- Develop final written guidance and procedures to state departments, agencies, and institutions for contract monitoring and enforcement;
- Consult with the Attorney General or his designee in developing final written guidance and procedures for the orderly and efficient submission of proposed state contracts to the Attorney General for review as provided in G.S. 114-8.3³ and G.S. 143-52.2;⁴
- In conjunction with the Office of State Personnel, create a Contracting Specialist career path that offers training and guidance on state law over purchasing and contracts in order to have a Contracting Specialist for each state agency;
- Work with the Office of State Personnel and the UNC School of Government to develop a rigorous contract management training and certification program for State employees.

As noted above, the General Assembly did not define a timeline for when the above objectives should be met.

Risk of Poor Contract Monitoring Practices Remains

Because the Division has not fully implemented the State Auditor's recommendations and enforced its increased authority outlined in Session Law 2010-194, the risk remains that state agencies will continue to conduct the same poor contract monitoring practices that were reported in the November 2010 performance audit report. An auditor review of the North Carolina Accounting System data indicates that state agencies spent approximately \$2.9 billion on purchased services in fiscal year 2011.⁵

Risks of poor contract monitoring practices reported in the November 2010 performance audit include:

- Failure to detect vendor noncompliance with contract terms and conditions;
- Poor quality service contract monitoring and poorly documented agreements that prevent the State from holding vendors accountable for performance;
- Inconsistent and poor quality monitoring;

³ *NC General Statute* 114-8.3 requires the Attorney General or his designee to review all proposed state contracts over \$1 million to ensure they are in proper legal form, contain all clauses required by law, are legally enforceable, and accomplish the intended purpose of the intended contract.

⁴ *NC General Statute* 143-52.2 requires every state department, agency, and institution to submit all state proposed contracts over \$1 million to the Attorney General or his designee for review in accordance with G.S. 114.8.3

⁵ Source: NCAS Statewide Accounting System – Statewide expenditures for Purchased Services, less line items for travel, utility and energy services, and communication and data processing services. The amount of non-IT related contracts can not be readily determined.

AUDIT FINDINGS AND RECOMMENDATIONS

- Inability to ensure that the contractor has fulfilled all contractual obligations and that there are no unresolved issues;
- Missed opportunities to identify and prevent poor performing vendors from obtaining future contracts;
- No preparation to prevent service delivery problems or detect problems early enough to prevent significant losses;
- Agencies may experience service disruptions and incur additional costs;
- Vendor responsibilities, deliverables, and schedules may not be clearly defined and met.

Also, without formal written guidance and procedures, state agencies may not be aware that they are required to submit all proposed state contracts over \$1 million to the Department of Justice for review.⁶ An auditor survey of state agencies indicates that 5 of the 35 respondents (14%) were not aware of this requirement.

Finally, without final written guidance for state agencies, the Division does not have the necessary tools to hold state agencies accountable and oversee their contract monitoring, planning and closing-out practices, and procedures over service contracts.

Implementation of the State Auditor Recommendations And Legislative Mandates Delayed

The Division states that final guidance for how agencies should submit contracts to the Department of Justice cannot be provided until the Department of Justice finalizes their procedures for this process. As of February 29, 2012, no such procedures have been provided. Conversely, the Department of Justice interprets statute to assign this responsibility to the Division. As such, no rules have been developed and provided in formal written guidance since the legislation became effective on October 1, 2010.

The Division stated that agencies sent comments in March 2011 that the draft written guidance developed for state contract monitoring was too vague and difficult to understand. The Division had also received comments in April 2011 from a consultant hired to review the existing state procurement system and provide recommendations for improvement.

The Division chose to incorporate the State Auditor's recommendations and legislative directives into the six work streams of its Procurement Transformation Project (Project). The Division states that the Project will overhaul the state's entire procurement system and create "a customer-focused enterprise to achieve increased procurement effectiveness, efficiency, and compliance."

However, the Division states the Project has experienced delays since it began due to staff turnover in key positions that are directly related to the Project. The State Purchasing Officer initially involved in developing the draft guidance for state contract monitoring left the

⁶ *NC General Statute 143-52.2*

AUDIT FINDINGS AND RECOMMENDATIONS

Department in March 2011. In addition, the Division lost its Procurement Transformation Project Manager in July 2011 and did not refill the position until January 2012.

Recommendations:

The Division should continue their work to finalize and provide written guidance on contract monitoring training, monitoring contract files, contract monitoring practices, contract close-out procedures, post review procedures, and necessary planning for effective contract monitoring by the December 31, 2012 target date and training on the written guidance by April 2013.

The Division should coordinate with the Attorney General to develop final written guidance and procedures for the orderly and efficient submission of proposed state contracts to the Attorney General for review as provided in G.S. 114-8.3⁷ and G.S. 143-52.2.⁸

The Division should continue their work with the Office of State Personnel to develop final position descriptions, career paths, and training programs that align with procurement related positions by the December 31, 2012 target date.

The Division should work with the Office of State Personnel and the UNC School of Government to develop a contract management certification program for state employees, including deciding on the type of certification and establishing timelines to have the program design completed.

⁷ *NC General Statute* 114-8.3 requires the Attorney General or his designee to review all proposed state contracts over \$1 million to ensure they are in proper legal form, contain all clauses required by law, are legally enforceable, and accomplish the intended purpose of the intended contract.

⁸ *NC General Statute* 143-52.2 requires every state department, agency, and institution to submit all state proposed contracts over \$1 million to the Attorney General or his designee for review in accordance with G.S. 114.8.3

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 Administration's (Department) response misleads the reader by arguing that 26 months is a reasonably prompt timeframe to develop contract monitoring guidance for state agencies.

By any reasonable standard, more than two years is not a prompt resolution of the issue.

As noted in the report, the facts are:

- The *Department of Administration, Division of Purchase and Contract – Service Contract Monitoring Practices* audit issued in November 2010 detailed poor contract monitoring practices across state government, provided best practices used by three other states, and recommended that the Department provide written guidance to state agencies;
- The General Assembly passed legislation effective October 1, 2010, requiring the Division to provide written guidance to state agencies;
- The Department developed and sent draft guidance to pilot agencies four months after the initial audit report but later scrapped the initial guidance;
- The Department elected to fold the contract monitoring guidance effort into its larger Procurement Transformation project;
- More than 20 months have passed since auditors recommended and legislators required contract monitoring guidance be provided to state agencies, and the Department does not expect to have a final product for another six months;

- Based on state accounting records for the fiscal year ending June 30, 2011, state agencies spend about \$242 million a month on purchased services.¹

As noted in the report, neither the State Auditor nor the General Assembly specified a timeframe for providing guidance to state agencies. Lacking a defined date, it was up to the Department to establish an appropriate timeframe.

Given the reported lack of adequate service contract monitoring across the state, the amount of money (\$242 million) the state spends on service contracts each month, and the contract monitoring best practices guidance provided to the Department during the prior audit, auditors concluded that 26 months to develop and issue guidance was not a reasonably prompt timeframe.

Government Accountability Office (GAO) standards state that government agencies should ensure “that the findings of audits and other reviews are promptly resolved.”² Though the term “promptly” is not defined in auditing standards, the federal government requires its agencies to resolve audit findings within six months.³

Regardless, the specifics of the situation should have prompted the agency to implement the recommendation and legislation sooner rather than later.

The Governor, Legislators, and the citizens of North Carolina should consider the clarification provided above when using this report to evaluate the Department’s progress in developing contract monitoring guidance for state agencies and holding government managers accountable for their programs.

¹ \$2.9 billion / 12 months = \$242 million per month.

² GAO Standards for Internal Control in the Federal Government. Pages 20-21.

³ Section 8(a) of U.S. Office of Budget and Management *Circular A-50*.

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North Carolina
Department of Administration

Beverly Eaves Perdue, Governor

Moses Carey, Jr., Secretary

June 5, 2012

The Honorable Beth Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
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Raleigh, NC 27699-0601

Dear Ms. Wood:

The Department of Administration acknowledges receipt of your follow up review of the November 2010 audit of service contract monitoring. As we stated when first apprised of the Auditor's desire to do this follow up, we would have preferred that the follow up be conducted at a later date due to the fact that the Department was still working to implement the recommendations. In saying this, we wish to emphasize that the purpose in establishing our timeline was to ensure both that we received full benefit from the third party analysis that was conducted for us just as your audit was being completed, and that our implementation plan would be coordinated with many other critical work streams which -- although outside the scope of your narrow audit -- were part of the total procurement review and improvement analysis.

In any event, we have reviewed the May 2012 document and agree that the recommendations from the first analysis have not been fully implemented for the reasons stated, although interim efforts have been made and are continuing now. As we noted in our many meetings and conversations with your staff, best practices in all areas of procurement (of which this is certainly a key) are a priority of the procurement transformation project and we anticipate to have completed our systematic, deliberate effort to finalize the final guidance and procedures for contract monitoring and enforcement by the end of the year. Any aspects of the mandates from S.L. 2010-194 that have not been fully implemented are very much in process as part of the overall multi-year implementation process and some of the tasks cannot begin until others are completed. None of them have been excluded from our implementation planning.

We have concerns about the area of your office's review addressing the reasonableness of the work by our Division of Purchase and Contracts to implement contract compliance procedures and training. The Department objects to the statement, made without context or support, that "26 months does not appear to be a reasonably prompt time frame" to finalize service contract monitoring practices.

We ask that your review be revised to describe the criteria that you believe should be used to determine reasonableness in this situation. Nothing in either your previous audit or this audit provides any standard for determining a "reasonable" time for completing this effort. Moreover, we have tried to be as forthcoming and candid as possible with your auditing staff about our actions, the progress of this

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transformation effort, the circumstances we have faced and our reasons for making the decisions we did about integrating compliance tasks into the larger project. Your report does not adequately address which of our actions and decisions your office believes should be reconsidered or what we should have done differently.

It is our understanding that the purpose of a performance audit is to provide an objective examination of evidence to assess the performance and management of a program against objective criteria.¹ Findings "should be supported by sufficient, competent, and relevant evidence,"² while recommendations "should logically flow from the findings and conclusions."³ Last, when describing performance issues, "auditors should put findings in context."⁴ In this case, the report does not include any evidence, criteria or basis for the finding that our progress has not been reasonable. Nor do the recommendations suggest any changes in the Division's existing plans and timeframes. Because the report lacks any facts or context that would support a contention that our efforts have lacked reasonable promptness, and absent a standard for measuring reasonableness under the circumstances, we request that this finding be deleted from the final report.

We concur with your recommendations that we should continue our work in this area (which we are doing), recognizing that much of this is contingent on continued joint efforts with the Attorney General's Office, the Office of State Personnel, and whatever action may occur that affects staffing levels in the General Assembly budget actions currently under review. Nevertheless, the Department of Administration is committed to implement both S.L. 2010-194 and those recommendations from the original audit in coordination with those from DOA's own review of how to improve and transform procurement.

Sincerely,



Moses Carey, Jr.

Cc: William Styres, Audit Manager
Anne Bander, Chief Operating Officer
Speros Fleggas, Deputy Secretary
Sam Byassee, Director, Division of Purchase & Contract
Robin Diehl, Chief Fiscal Officer

¹ Government Accountability Office, *Government Auditing Standards*, Section 2.10.

² *Id.* at Section 8.13.

³ *Id.* at Section 8.28.

⁴ *Id.* at Section 8.46.

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