

STATE OF NORTH CAROLINA

DEPARTMENT OF LABOR
ELEVATOR AND AMUSEMENT DEVICE BUREAU
WAGE AND HOUR BUREAU
INSPECTION, VIOLATION AND PENALTY PROCESS

FINANCIAL RELATED AUDIT

JUNE, 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

EXECUTIVE SUMMARY

PURPOSE

This audit report evaluates penalty assessment, tracking, and collection processes at the Department of Labor's Elevator and Amusement Device Bureau (Elevator Bureau) and Wage and Hour Bureau (Wage Bureau).

BACKGROUND

The Elevator Bureau and Wage Bureau can assess penalties for violations of applicable statutes and regulations found during inspections and investigations. Proceeds of penalties assessed are required to be deposited into the Civil Penalty and Forfeiture Fund, which is then appropriated to local school systems.

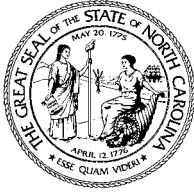
KEY FINDINGS

- Only 3% of the elevators with violations in 2012 had a follow-up inspection.
- Elevator penalty reductions and waivers deviate from state law and internal policy.
- Elevator penalties are nominal. They are rarely imposed and small when they are.
- The Wage Bureau did not complete follow up investigations on agreements made with companies to correct violations of labor laws.
- Wage Bureau investigators assess and collect penalties, which increases the risk of error and fraud.

KEY RECOMMENDATIONS

- The Elevator Bureau should follow up on violations and corrective actions.
- Elevator penalty reductions should be calculated in accordance with statute and policy.
- The Elevator Bureau should consider stricter penalty assessment.
- The Wage Bureau should follow up on compliance agreements.
- The Wage Bureau should prohibit investigators from collecting fines.

The key findings and recommendations in this summary are not inclusive of all the findings and recommendations in the report.



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AUDITOR'S TRANSMITTAL

June 13, 2013

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
The Honorable Cherie Berry, Commissioner, Department of Labor

This report presents the results of our financial related audit at the Department of Labor, Elevator and Amusement Device Bureau and Wage and Hour Bureau. 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 objective of our audit was to identify improvements needed in penalty assessment, tracking, and collection processes at the Elevator and Amusement Device Bureau and Wage and Hour Bureau.

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 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 AND GENERAL OBJECTIVE

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 Labor (Department). Along with other state agencies, the Department assesses civil penalties and collects proceeds that are required to be deposited into the Civil Penalty and Forfeiture Fund. Under *General Statute* 115C-457.3, the General Assembly appropriates moneys from this fund to local school systems. Examples of proceeds collected by the Department include civil penalties assessed for:

- Violations of the Elevator Safety Act and Amusement Device Safety Act of North Carolina, and
- Violations of the Wage and Hour Act and Controlled Substance Examination Regulation.

There were no special circumstances that caused auditors to conduct the audit, but rather it was performed as part of an effort to periodically examine and report on the financial practices of state agencies and institutions.

GENERAL OBJECTIVE

The general objective of a financial related audit may include determining whether 1) the organization has complied with finance-related laws, regulations, and/or provisions of contracts or grant agreements, 2) assets have been safeguarded, or 3) financial resources have been prudently managed. In conjunction with this objective, auditors also sought to identify improvements needed in internal control over selected fiscal matters. The specific fiscal matters included in the audit are described in the *Audit Scope and Specific Objectives* section.

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. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. This audit does not provide a basis for rendering an opinion on internal control, and consequently, no such opinion has been issued.

AUDIT SCOPE AND SPECIFIC OBJECTIVES

The audit scope covered the period from January 1, 2012, to December 31, 2012, for the Elevator and Amusement Device Bureau and July 1, 2012, to December 31, 2012, for the Wage and Hour Bureau. However, transactions from earlier periods were reviewed to gather sufficient and appropriate evidence to support audit findings. The specific objective of our audit was to determine if the Bureaus and Department of Labor effectively enforce violations and track and collect assessed penalties.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the *Audit 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 interviewed personnel, observed operations, reviewed policies, analyzed records, and examined documentation supporting recorded transactions and balances. We applied a judgmental approach to our sample of penalties assessed. As a result, we were unable to project our results to the population.

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/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the *Audit Findings and Recommendations* 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 RECOMMENDATIONS

1. ENFORCEMENT AND TRACKING OF ELEVATOR AND AMUSEMENT RIDE VIOLATIONS IS DEFICIENT

The Elevator and Amusement Device Bureau (Elevator Bureau) performs limited follow-up inspections; does not enforce a requirement that violators submit a corrected violation form; and deviates from state law and its own internal procedures when reducing penalties. The procedures for tracking and processing violations need improvement.

Follow-up on Violations is Minimal

Evidence shows only 3% of the elevators (436) found in violation in 2012 had follow-up inspections to determine if corrective actions were taken.

In 2012, Elevator Bureau inspectors found about 30,300 violations of various degrees of severity associated with 13,138 elevators during routine inspections. These violations ranged from minor violations (e.g. a dirty elevator pit) to more serious issues (e.g. phones not working and fire service not working).¹

Corrective Violation Forms Not Tracked

The Elevator Bureau does not track or monitor whether it receives notification (corrective action forms) that equipment is brought into compliance. The North Carolina Administrative Code² requires the owners of noncompliant elevators to make such notification in writing to the Elevator Bureau.

Limited follow-up inspections and monitoring of corrective action forms prevents the Elevator Bureau from knowing whether violations are addressed in a timely way or if noncompliant elevators operated until the next annual inspection, unnecessarily increasing the risk to public safety.

From 2010 to 2012, about 1,150 elevators had the same violations for at least two consecutive years.

Documentation for Penalty Reduction Not Maintained

While state law provides the Elevator Bureau the authority to reduce penalties as part of its initial penalty assessment,³ the Elevator Bureau does not retain documentation for its penalty reduction decisions. The Elevator Bureau routinely reduces the amount of the initial penalty assessment as allowed under state law. Based on a sample of seven elevator penalties assessed in 2012, all seven (100%) were reduced from the initial assessed amounts.

¹ Elevators that pose imminent danger to the public (serious injury or death) are shut down.

² Section .0307 of Title 13, Chapter 15

³ *General Statute § 95-110.10 and § 95-111.13*

AUDIT FINDINGS AND RECOMMENDATIONS

Penalty Reductions and Waivers Deviate from State Law and Bureau Policy

While state law provides the Elevator Bureau the authority to reduce penalties as part of its initial assessment,⁴ larger penalty reductions are usually granted because General Statute and Elevator Bureau policy are not followed in two areas.

First, the Elevator Bureau's internal penalty calculation matrix allows a 10% reduction for a business that has not received a **penalty** (emphasis added) in the past 12 months. However, state law specifies that reductions be based in part on "...the record of previous **violations**" (emphasis added). Because penalties are rarely enforced, businesses receive an almost automatic penalty reduction because it is based on prior penalties instead of prior violations as stated in law.

Second, the headcount at the elevator company's smaller **field office** (emphasis added) is often used for the reduction calculation. However, the Elevator Bureau's internal policy states that "size of business will be measured on the basis of the maximum number of employees of an employer at all workplaces **nationwide** (emphasis added) at any one time during the previous 12 months." As a result, a larger reduction is usually given since the rate of reduction grows gradually higher as the size of business decreases (field office versus nationwide).

In addition, a \$25,200 penalty was erroneously waived in 2010 for an elevator company field office that already received a waiver in 2008 for the same type of violations. Both waiver letters clearly stated that penalties will be incurred for any future violations of that type. The Elevator Bureau also does not have detailed criteria for penalty waivers, which can lead to inconsistency over time, especially when inspection results are not tracked and Elevator Bureau staff change.

Penalties Assessed and Collected are Nominal

The Elevator Bureau assesses few penalties against noncompliant elevator companies. Of the 13,138 elevators with violations in 2012, only 0.3% (36) had penalties assessed even though about 1,150 elevators had repeat violations for at least two consecutive years. The violations ranged from minor violations (e.g. a dirty elevator pit) to more serious issues (e.g. phones not working and fire service not working).⁵

During calendar year 2012, the Elevator Bureau issued \$7,400 in penalties for elevator violations and had collected \$4,650 at the time of audit. Penalties issued in 2011 and 2010 were \$1,650 and \$3,325, respectively.

Until a policy change in 2012, the Elevator Bureau assessed penalties based on the actual number of days the unit or equipment was operated or used with a known violation. As allowable under the Elevator Safety Act and Amusement Device Safety Act (Acts), any

⁴ *General Statute § 95-110.10 and § 95-111.13*

⁵ Elevators that pose imminent danger to the public (serious injury or death) are shut down.

AUDIT FINDINGS AND RECOMMENDATIONS

person who violates the Acts shall be subject to a civil penalty per day “for each day each device or equipment is operated or used.”

In 2012, the Elevator Bureau changed its penalty assessment policy due to concern over “proving” a violation if a penalty was contested in a non-elevator type device.⁶ Currently, penalties are assessed only for the day the violations are found (i.e., one day). However, determining days of noncompliant use for elevators was not previously an issue as building maintenance and elevator company personnel were familiar with elevator operations.

The Elevator Bureau’s change in policy further reduces penalties it could have assessed to enforce elevator safety laws and regulations. Under the new policy, penalties assessed will be even smaller and less effective to encourage compliance and prevent repeated elevator violations.

If the Elevator Bureau issued a one-day penalty, in accordance with its internal policy, for the 1,150 elevators found to be in violation for two or more consecutive years, it could have collected an additional \$143,750⁷ in 2012 as part of its routine inspections. That amount is 19 times greater than the amount actually assessed in 2012.

Omissions and Errors in Penalty Tracking

Nine elevator penalties assessed by field inspectors around December 2012 were missing from the Elevator Bureau’s penalty tracking spreadsheet. The missing penalties comprised 28% of elevator penalties assessed in 2012. Penalty amount and payment status errors were also noted in the Elevator Bureau’s tracking spreadsheet.

As a result, penalties not submitted to the Elevator Bureau office will not be tracked and collected. Misstated penalty amounts and payment status also affect the accuracy of quarterly financial reporting and may prevent penalties from being collected.

The Elevator Bureau did not detect this omission because it does not have procedures in place to ensure penalties assessed by field inspectors are submitted to the Elevator Bureau office for recording and billing. Penalty tracking spreadsheets are not periodically reconciled or validated with penalties assessed to ensure accuracy.

Penalties Not Pursued Timely

The Department of Labor’s Budget Office penalty collection procedures require a friendly reminder, a dunning letter,⁸ and a Notice of Final Order sent in 30-day intervals before the overdue penalty is turned over to the Attorney General for further collection. However,

⁶ Primarily inflatable amusement devices for children (e.g. moon jump or obstacle course).

⁷ Assumes a 50% reduction (based on size of business, gravity of violation, good faith and record of previous violations as allowed per Statute) of the minimum daily rate of \$250 ($\$250 \times 50\% \times 1,150 = \$143,750$).

⁸ A dunning letter is a letter that demands a payment of a debt.

AUDIT FINDINGS AND RECOMMENDATIONS

the Budget Office's procedures do not take into account processing time for each collection step (e.g., dunning letter or Notice of Final Order).

As a result, overdue penalties are not turned over to the Attorney General for collection within 90 days as required in the State Cash Management Plan⁹ and the Department's penalty collection procedures. A review of selected penalties shows delays ranging from two weeks to four months between each of the Department's three collection steps.¹⁰

Recommendations

The Elevator Bureau should consider stricter enforcement of penalty assessment and collection in accordance with its authority under state law.

The Elevator Bureau should establish a mechanism to monitor the effectiveness of its enforcement strategy including penalty assessment, follow-up inspection, and compliance notification to ensure the safety of the equipment it regulates pursuant to its authority under state law.

The Elevator Bureau should develop a process to ensure appropriate corrective action forms are submitted when the owner fixes a noncompliant device.

The Elevator Bureau should implement procedures to ensure that penalty reductions are calculated in accordance with applicable statute and internal policy, that waivers are granted in accordance with specific criteria, and that documentation is retained for penalty reductions and waivers.

The Elevator Bureau should implement procedures to ensure all penalties that should have been levied are captured and communicated to the Elevator Bureau office for tracking and collection. The Elevator Bureau should also implement procedures to ensure accuracy of penalty information from initial assessment to collection.

The Budget Office should manage penalty collection in accordance with the State Cash Management Plan and its internal policy.

Agency Response

The Elevator Bureau will evaluate its current penalty assessment policies to determine whether any changes will result in greater compliance with the act.

The Elevator Bureau is working with the Office of the State Controller to implement a new software system to track all aspects of penalty assessment including:

⁹ *General Statute Chapter 147 Article 6A*

¹⁰ Penalties collected are required to be deposited into the Civil Penalty and Forfeiture Fund, which is then appropriated to local school systems.

AUDIT FINDINGS AND RECOMMENDATIONS

- Corrected violation forms to ensure confirmation of abatement for cited violations is received by the Elevator Bureau in a timely manner.
- Data that can be analyzed to determine the effectiveness of the Bureau's enforcement strategy.
- Tracking of penalties assessed in the field.

The Elevator Bureau policy addressing penalty calculation clearly states the criteria to be used when calculating penalties. The Bureau will re-educate all employees on the proper calculation of penalties using the penalty adjustment factors set out in the Bureau's Operations Manual. This re-education will also include the necessity to retain supporting documentation for the penalty reduction. The Bureau Chief is in the process of adopting written criteria for use during the informal conference in evaluating requests for reductions to the initial penalty amount.

Budget is eliminating its dunning/demand letter and referring the matter to the Attorney General's office if the penalty is not paid within 30 days of the "friendly reminder" letter. If the penalty is not paid within 30 days of the Attorney General's demand letter, Budget will file the Notice of Final Order. Moving the referral to the Attorney General's office earlier in the collection process ensures that all past due billings are referred to the Attorney General within 90 days of it becoming past due. The majority of the billings sent to the Attorney General are less than \$500 and are not statutorily required to be sent to the Attorney General for collection.

AUDIT FINDINGS AND RECOMMENDATIONS

2. ENFORCEMENT AND TRACKING OF WAGE AND HOUR VIOLATIONS NEEDS IMPROVEMENT

The Wage and Hour Bureau¹¹ (Wage Bureau) cannot tell if labor law violations were addressed, or if violations continue to exist and penalties need to be assessed, where compliance agreements¹² were made. A review of 11 compliance agreements showed that none had follow-up investigations. Additionally, Wage Bureau field investigators are allowed to assess, record, and collect penalties, increasing the risk of errors and fraud. Finally, the Wage Bureau did not adequately track penalties assessed to ensure timely collection.

No Follow-up on Compliance Agreements

Wage Bureau investigators did not complete follow up investigations for any of the 11 compliance agreements selected for testing. The lack of follow-up investigations has two effects. First, there is no assurance the business actually corrected these violations. Secondly, by not verifying compliance, the Wage Bureau cannot assess penalties meant to force compliance.¹³

Wage Bureau investigators may award a compliance agreement to a first-time offender who met the conditions set out in its internal policy (e.g., cooperates during the investigation.) A compliance agreement allows the business to have the penalty waived if a follow-up investigation finds that all violations have been addressed.

According to Wage Bureau internal procedures, the follow-up investigation is required within 180 days of the agreement and if a follow-up investigation finds the same violation, the business will be liable for the full penalty originally assessed with no reduction plus an additional penalty for the violations found during the follow-up investigation.

Penalty Collection by Field Investigators Increases Risk of Error and Fraud

Wage Bureau field investigators collect penalty payments, which could lead to error or fraud since the same individual has control over assessing, recording, and collection of the penalty. Field investigators routinely send collection letters instructing businesses to mail penalty payments directly to the investigator's PO Box. If a penalty remains uncollected after two weeks, field investigators are supposed to send the penalty information to the Wage Bureau office for follow up.

The Standards for Internal Control issued by US General Accounting Office explicitly states "key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud."

¹¹ The Wage Bureau enforces laws covering minimum wage, maximum hours, wage payment, and child labor. It also enforces the Private Personnel Service Act and the Controlled Substance Examination Regulation Act.

¹² A compliance agreement (which may be awarded to a first-time offender) allows the penalty to be waived if a follow-up investigation finds that all violations have been addressed.

¹³ Proceeds of penalties assessed are deposited into the Civil Penalty and Forfeiture Fund, which is then appropriated to local school systems.

AUDIT FINDINGS AND RECOMMENDATIONS

The Department of Labor Budget and Management Office (Budget Office) does not have a written policy to prevent field investigators from collecting penalty payment.

Wage and Hour Penalties Are Not Adequately Tracked

The Wage Bureau's current procedures are inadequate to ensure penalties assessed by field investigators are submitted to it for tracking and collection. As a result, penalties not captured by the Wage Bureau office will not be tracked and collected.

In addition, the Wage Bureau does not reconcile its database with penalty information maintained by the Department of Labor's Budget Office. Penalty information therefore may be inaccurate and affect collection efforts by the Budget Office.

Penalties Not Pursued In A Timely Way

The Department's Budget Office penalty collection procedures require a friendly reminder, a dunning letter, and a Notice of Final Order sent in 30-day intervals before the overdue penalty is turned over to the Attorney General for further collection. However, the Budget Office's procedures do not take into account processing time for each collection step (e.g., dunning letter, Notice of Final Order).

As a result, overdue penalties are not turned over the Attorney General for collection within 90 days as required in the State Cash Management Plan¹⁴ and the Department's penalty collection procedures. A review of selected penalties shows delays ranging from two weeks to two months between each of the Department's three collection steps.¹⁵

Recommendations

The Wage Bureau should implement procedures to ensure follow-up investigations for compliance agreements are completed within the required time frame.

The Wage Bureau and Budget Office should implement a policy preventing the collection of payments by field investigators.

The Wage Bureau should implement procedures to ensure all penalties are captured at the correct amounts and communicated to the Wage Bureau and Budget Office for tracking and collection.

The Budget Office should manage penalty collection in accordance with the State Cash Management Plan and its internal policy.

¹⁴ *General Statute Chapter 147 Article 6A*

¹⁵ Penalties collected are required to be deposited into the Civil Penalty and Forfeiture Fund, which is then appropriated to local school systems.

AUDIT FINDINGS AND RECOMMENDATIONS

Agency Response

The Wage and Hour Bureau has adopted new written procedures (became effective 1 April 2013) to ensure:

- Follow up investigations are completed in a timely manner.
- Investigators no longer collect penalty payments. The Budget Office is in the process of adopting a policy that requires all penalties, inspection fees and registration fees due to the Department of Labor to be sent directly to the Budget Office. It prohibits the collection of these monies in the field.
- Tracking and correct penalty amounts are communicated to administrative staff and Budget in a timely manner. Investigators are now required to forward all civil money penalties by email the same day of their final conference with the employer or no later than one business day after final conference for processing by administrative staff. One person is now in charge of reviewing, reconciling and reporting information on one spreadsheet to Budget. Wage and Hour is in the process of obtaining a new computer system that will help in tracking and collecting penalties.

Budget is eliminating its dunning/demand letter and referring the matter to the Attorney General's office if the penalty is not paid within 30 days of the "friendly reminder" letter. If the penalty is not paid within 30 days of the Attorney General's demand letter, Budget will file the Notice of Final Order. Moving the referral to the Attorney General's office earlier in the collection process ensures that all past due billings are referred to the Attorney General within 90 days of it becoming past due. The majority of the billings sent to the Attorney General are less than \$500 and are not statutorily required to be sent to the Attorney General for collection.

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