

# STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

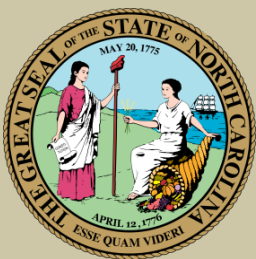
BETH A. WOOD, CPA



## DEPARTMENT OF TRANSPORTATION

### SALARY ADJUSTMENTS

PERFORMANCE AUDIT  
JULY 2020



**NCOSA**  
The Taxpayers' Watchdog

# EXECUTIVE SUMMARY

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## **PURPOSE**

The purpose of this audit was to determine whether the Department of Transportation (Department) made 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5.<sup>1</sup>

## **BACKGROUND**

In 2018, the General Assembly enacted Session Law 2018-5. The law authorized a pilot program that gave the Department the flexibility to make salary adjustments and use retention funds<sup>2</sup> without having to comply with the State Human Resources Commission's compensation rules.

In exchange for receiving salary adjustments that were exempt from state compensation rules, the law required Department employees who received the salary adjustments to relinquish claims to longevity pay<sup>3</sup> and career status.<sup>4</sup> The law also limited the total amount of salary adjustments to two percent of the Department's payroll expense.

## **KEY FINDING**

The Department did not make 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5. Department employees received salary adjustments that did not comply with state compensation rules, but the employees did not relinquish claims to longevity and career status as required by state law. Additionally, the total amount of salary adjustments exceeded the two-percent-of-payroll-expense limit.

As a result, the Department:

- Gave its employees an unfair advantage by allowing them to retain all of the benefits and protections of state employment even though they received compensation that was not available to state employees under state compensation rules
- Demonstrated to all other state agencies that noncompliance with state laws, whether intentionally or through lack of appropriate due diligence, has no consequences for the agency or management
- Overspent \$39 million on its salary adjustments

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<sup>1</sup> See Appendix A for the complete Section 34.19 of Session Law 2018-5.

<sup>2</sup> Retention salary adjustments are used to maintain employment of a key employee who has a similar job offer outside the government structure.

<sup>3</sup> Longevity pay is an annual lump sum payment made to state employees with at least ten years of total State service to recognize long-term service. The amount of longevity pay varies between 1.5% to 4.5% depending on the employee's total years of service.

<sup>4</sup> A career state employee is a state or local government employee who is in a permanent position and has been continuously employed in a position subject to the State Personnel Act for the immediate 12 preceding months. Career status provides a level of employment security. Prior to achieving career status, an employee may be separated from service for performance or personal conduct causes without right of appeal or hearing (except in cases of discrimination). Once an employee has achieved career status, the employee may only be separated from service for performance or personal conduct causes by following the state Disciplinary Action, Suspension and Dismissal policy. Additionally, a career state employee has the right of appeal or hearing.

# EXECUTIVE SUMMARY (CONCLUDED)

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## **KEY RECOMMENDATIONS**

The Department should consult with appropriate legislative bodies to determine the intent of state laws before implementing programs.

The Department should consider taking corrective action to bring the Department into compliance with Session Law 2018-5.

The Joint Legislative Transportation Oversight Committee should determine whether Department management performed appropriate due diligence to ensure the intent of Session Law 2018-5 was met and take appropriate action if not.

## **MATTERS FOR FURTHER CONSIDERATION**

The Department should obtain clarification about the legislative intent of Section 34.19 of Session Law 2018-5 before making salary adjustments for the Division of Motor Vehicles.

STATE OF NORTH CAROLINA  
**Office of the State Auditor**



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## AUDITOR'S TRANSMITTAL

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The Honorable Roy Cooper, Governor  
Members of the North Carolina General Assembly  
J. Eric Boyette, Secretary, Department of Transportation  
Michael S. Fox, Chairman, Board of Transportation

Ladies and Gentlemen:

We are pleased to submit this performance audit report titled *Department of Transportation, Salary Adjustments*. The audit objective was to determine whether the Department of Transportation made 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5.

The Department of Transportation Secretary, Eric Boyette, reviewed a draft copy of this report. His written comments are included starting on page 21.

This audit was conducted in accordance with Chapter 147, Article 5A of the *North Carolina General Statutes*.

We appreciate the courtesy and cooperation received from management and the employees of the Department of Transportation during our audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

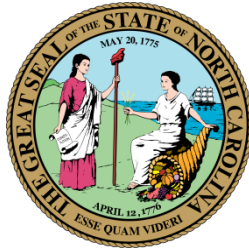


**Beth A. Wood, CPA**  
**State Auditor**

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# BACKGROUND

In 2018, the General Assembly enacted Session Law 2018-5. The law authorized a pilot program that gave the Department of Transportation (Department) the flexibility to make salary adjustments and use retention funds<sup>5</sup> without having to comply with the State Human Resources Commission's compensation rules.

In exchange for receiving salary adjustments that were exempt from state compensation rules, Section 34.19 of Session Law 2018-5 required Department employees who received the salary adjustments to relinquish claims to longevity pay<sup>6</sup> and career status.<sup>7</sup> The law also limited the total amount of salary adjustments to two percent of the Department's payroll expense.

In part,<sup>8</sup> the law stated: [*Emphasis Added*]

SECTION 34.19.(a). Subject to the approval of the Secretary of the Department of Transportation, **employees** of the Department of Transportation (Department) **who voluntarily relinquish** (i) annual longevity payments or **any claim to longevity pay** and (ii) **any claim to career status** or eligibility for career status **are exempt from:**

- (1) The classification and **compensation rules established by the State Human Resources Commission** pursuant to G.S. 126 4(1) through (4).

SECTION 34.19.(c). For the 2018 2019 fiscal year and the 2019 2020 fiscal year, **the sum equal to two percent (2%) of the total Highway Fund and Highway Trust Fund appropriation** for the applicable fiscal year for **the payroll expenses** of the Department **may be used for the purposes of:**

- (1) **Salary adjustments** within the Department to provide competitive salary rates and to address changes in labor market salary rates as documented through the Department's data collection and analysis according to accepted human resource professional practices and standards.

The intent of the law was summarized by the General Assembly's Fiscal Research Division in the *2018 Annotated Joint Conference Committee Report on the Base and Expansion Budget* on page J52:

#### PILOT PROGRAM / DOT SALARY ADJUSTMENT & RETENTION FUNDS

Authorizes a 2-year pilot program through June 30, 2020, to allow DOT flexibility in setting salaries **for employees who voluntarily relinquish longevity and career status. DOT may use up to 2% of payroll** for the purpose of salary adjustments, reallocation of positions, and recruitment and retention. [*Emphasis Added*]

<sup>5</sup> Retention salary adjustments are used to maintain employment of a key employee who has a similar job offer outside the government structure.

<sup>6</sup> Longevity pay is an annual lump sum payment made to state employees with at least ten years of total State service to recognize long-term service. The amount of longevity pay varies between 1.5% to 4.5% depending on the employee's total years of service.

<sup>7</sup> A career state employee is a state or local government employee who is in a permanent position and has been continuously employed in a position subject to the State Personnel Act for the immediate 12 preceding months. Career status provides a level of employment security. Prior to achieving career status, an employee may be separated from service for performance or personal conduct causes without right of appeal or hearing (except in cases of discrimination). Once an employee has achieved career status, the employee may only be separated from service for performance or personal conduct causes by following the state Disciplinary Action, Suspension and Dismissal policy. Additionally, a career state employee has the right of appeal or hearing.

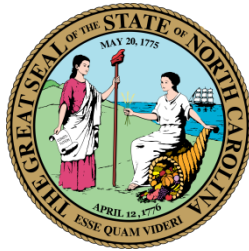
<sup>8</sup> See Appendix A for the complete Section 34.19 of Session Law 2018-5.

The intent of the law was also summarized in the May 29, 2018, *Joint House and Senate Committee on Appropriations Conference Report on Senate Bill 99, Appropriations Act of 2018* meeting minutes on page 15:

Provision 7 is a pilot program. It allows DOT flexibility for a period of two years in setting salaries **for DOT employees who voluntarily relinquish longevity and career status**. It also enables **DOT to use up to two percent or \$11.7 million per payroll** for the purpose of salary adjustments, reallocation of positions, retention and recruitment programs. [*Emphasis Added*]

During the 2018-2019 fiscal year, the Department had approximately 9,338 employees and appropriated payroll expenses of \$981.4 million.





# **OBJECTIVE, SCOPE, AND METHODOLOGY**

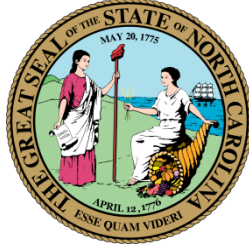
The audit objective was to determine whether the Department of Transportation (Department) made 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5.

To achieve the audit objective, auditors interviewed Department personnel, Office of State Human Resources personnel, Joint Legislative Transportation Oversight Committee members and members of the General Assembly's Fiscal Research Division. Auditors reviewed Department policies and procedures, financial information, reports, memos, and emails. Auditors also reviewed payroll information from the Office of the State Controller.

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

As a basis for evaluating internal control, auditors applied the internal control guidance contained in professional auditing standards. However, our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion. See Appendix B on page 13 for internal control components and underlying principles that were significant to our audit objective.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to support the findings and conclusions in relation to 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**

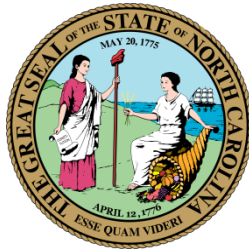
The Department of Transportation (Department) did not make 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5. The Department gave salary adjustments to employees who did not relinquish claims to longevity pay<sup>9</sup> and career status<sup>10</sup> as required by state law. Additionally, the total amount of salary adjustments exceeded the two-percent-of-payroll-expense limit.

As a result, the Department gave its employees an unfair advantage by allowing them to retain all of the benefits and protections of state employment even though they received compensation that was not available to state employees under state compensation rules. The Department also demonstrated to all other state agencies that noncompliance with state laws, whether intentionally or through lack of appropriate due diligence, has no consequences for the agency or management. Additionally, the Department overspent \$39 million on its salary adjustments.

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<sup>9</sup> Longevity pay is an annual lump sum payment made to state employees with at least ten years of total State service to recognize long-term service. The amount of longevity pay varies between 1.5% to 4.5% depending on the employee's total years of service.

<sup>10</sup> A career state employee is a state or local government employee who is in a permanent position and has been continuously employed in a position subject to the State Personnel Act for the immediate 12 preceding months. Career status provides a level of employment security. Prior to achieving career status, an employee may be separated from service for performance or personal conduct causes without right of appeal or hearing (except in cases of discrimination). Once an employee has achieved career status, the employee may only be separated from service for performance or personal conduct causes by following the state Disciplinary Action, Suspension and Dismissal policy. Additionally, a career state employee has the right of appeal or hearing.



# **FINDING, RECOMMENDATIONS, AND RESPONSES**

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**DEPARTMENT FAILED TO COMPLY WITH STATE LAW, GAVE ITS EMPLOYEES AN UNFAIR ADVANTAGE, DEMONSTRATED THAT NONCOMPLIANCE HAS NO CONSEQUENCES, AND OVERSPENT \$39 MILLION ON SALARY ADJUSTMENTS**

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Under a Pilot Program established by Section 34.19 of Session Law 2018-5,<sup>11</sup> Department of Transportation (Department) employees received salary adjustments that did not comply with state compensation rules, but the employees did not relinquish claims to longevity pay<sup>12</sup> and career status<sup>13</sup> as required by the law. Additionally, the total amount of salary adjustments exceeded the two-percent-of-payroll-expense limit.

As a result, the Department gave its employees an unfair advantage over other state employees who were compensated in accordance with state compensation rules. The Department also demonstrated to all other state agencies that noncompliance with state laws, whether intentionally or through lack of appropriate due diligence, has no consequences for the agency or management. Additionally, the Department overspent \$39 million on its salary adjustments.

The Department failed to comply with state law because it did not consult with the Joint Legislative Transportation Oversight Committee or the General Assembly's Fiscal Research Division to ensure that the Department's interpretation of the law was correct.

**Did Not Make Salary Adjustments in Accordance with State Law**

For state fiscal year (SFY) 2019, the Department failed to comply with the Pilot Program established in Section 34.19 of Session Law 2018-5 in two ways.

First, the Department never made relinquishment of longevity pay and career status a condition for receiving salary adjustments that did not comply with state compensation rules. Consequently, none of the Department's employees requested approval to relinquish claims to longevity pay and career status.

In its July 1, 2019, report to the Joint Legislative Transportation Oversight Committee and Fiscal Research Division of the General Assembly, the Department wrote:

Pursuant to Section 34.19.(a), the Secretary of the Department of Transportation **did not** approve any employees to voluntarily relinquish (i) annual longevity payments or any claim to longevity pay and (ii) any claim to career status or eligibility for career status as set out in Session Law 2018-5, Section 34.19.(a).  
*[Emphasis Added]*

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<sup>11</sup> In 2018, the General Assembly enacted Session Law 2018-5. The law authorized a pilot program that gave the Department the flexibility to make salary adjustments and use retention funds without having to comply with the State Human Resources Commission's compensation rules.

<sup>12</sup> Longevity pay is an annual lump sum payment made to state employees with at least ten years of total State service to recognize long-term service. The amount of longevity pay varies between 1.5% to 4.5% depending on the employee's total years of service.

<sup>13</sup> A career state employee is a state or local government employee who is in a permanent position and has been continuously employed in a position subject to the State Personnel Act for the immediate 12 preceding months. Career status provides a level of employment security. Prior to achieving career status, an employee may be separated from service for performance or personal conduct causes without right of appeal or hearing (except in cases of discrimination). Once an employee has achieved career status, the employee may only be separated from service for performance or personal conduct causes by following the state Disciplinary Action, Suspension and Dismissal policy. Additionally, a career state employee has the right of appeal or hearing.

Second, the Department did not limit the total amount of salary adjustments to two percent (\$19.6 million) of the SFY 2019 appropriated payroll expense (\$981.4 million).<sup>14</sup>

Instead, the state payroll system shows that the Department gave 7,379 employees salary adjustments totaling approximately \$58.5 million.

### **Resulted in Department's Employees Receiving an Unfair Advantage**

By not complying with state law, the Department gave its employees an unfair advantage. The Office of State Human Resources writes:<sup>15</sup>

Historically, pay administration policies for promotion, reallocation, salary range revision, special entry rates, and performance pay have interacted comprehensively to provide **a pay system that is fair and equitable**. [*Emphasis Added*]

Section 34.19 (a) of Session law 2018-5 continues that system of fairness and equity. The law allows the participants in the Pilot Program to be exempt from the State's compensation rules, but the participants must relinquish claims to longevity pay and career status.

However, the Department allowed participants in the Pilot Program to receive compensation exempt from the limitations imposed by the State's compensation rules and still retain all of the benefits and protections of state employment.

For example:

- 5,422 employees received salary adjustments greater than 10% totaling \$52 million (salaries exceeded the 10% limit by \$26.1 million).<sup>16</sup>
- 203 employees with active disciplinary actions received salary adjustments totaling \$1.5 million.<sup>17</sup>
- 10 employees that "did not meet expectations" received salary adjustments totaling \$72,671.<sup>18</sup>

And of the 7,379 Department employees who received salary adjustments in state fiscal year 2019:

- 6,876 employees had and retained career status.
- 4,747 employees were eligible for longevity pay and received a total of \$8.3 million.<sup>19</sup>

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<sup>14</sup> NC Certified Budget BD307(R).

<sup>15</sup> State Human Resources Manual, Salary Administration, Section 4, Page 135.

<sup>16</sup> Inconsistent with the State's In-Range Adjustments policy.

<sup>17</sup> Inconsistent with the State's Agency Performance Management policy.

<sup>18</sup> Inconsistent with the State's Agency Performance Management policy.

<sup>19</sup> Auditor estimate. Auditors calculated longevity payments for those employees that received salary adjustments with at least ten years at the time of the salary adjustment. The amount of longevity pay per employee varied between 1.5% to 4.5% depending on the employee's total years of service.

**Also Resulted in Demonstration that Noncompliance Has No Consequences**

The Department also demonstrated to all other state agencies that noncompliance with state laws, whether intentionally or through lack of appropriate due diligence, has no consequences for the agency or management.

In May 2019, local media reported that Department employees would be allowed to keep the raises received under the Pilot Program. State Senate budget writers were reported to have reached an agreement with Department to “receive notification if the department uses the provision for further increases.”<sup>20</sup>

No punitive action was taken against the Department or Department management for not performing appropriate due diligence to ensure the intent of Session Law 2018-5 was met.

**Also Resulted in \$39 Million Overspent on Salary Adjustments**

The Department gave \$58.5 million in salary adjustments which exceeded the state law’s \$19.6 million limit.<sup>21</sup>

Consequently, the Department overspent \$39 million that could have been used for other operational needs or to address funding shortfalls.

**Caused by Failure to Consult with Legislative Committee and Fiscal Research**

The Department failed to consult with the Joint Legislative Transportation Oversight Committee and the General Assembly’s Fiscal Research Division to understand the intent of Section 34.19 of Session Law 2018-5.

Instead, the Department’s leadership<sup>22</sup> team developed its own interpretation by consulting with the Department’s legal team. The Department also inquired with the Attorney General’s Office but did not receive a formal or informal opinion.

According to Department’s Chief Operating Officer (COO) and Interagency Director the Department decided that:

- Each paragraph of the law should be interpreted separately. Consequently, the requirement to relinquish longevity pay and career status was not considered to be linked to the salary adjustments.
- This was a one-time department wide compensation adjustment rather than individual raises to employees. Salary adjustments would be made at the job category level based on market study recommendations.
- The Department could use up to 2% (\$75 million for SFY 2019) of the Highway Fund and Highway Trust Fund appropriations (\$3.76 billion for SFY 2019).

<sup>20</sup> Raleigh News & Observer, [Senate leaders let NCDOT pay raises stand](#), May 28, 2019.

<sup>21</sup> 2% of the \$981.4 appropriated payroll expense for SFY 2019.

<sup>22</sup> Included the Secretary, COO, and Interagency Director.



The Department then **informed** the Office of State Human Resources of its interpretation in an email dated July 3, 2018. The Department's COO wrote, in part:

My assessment of the Section is the following:

- 1) Broadly, the intent of this legislation is to give NCDOT the opportunity [to] initiate a Pilot to better recruit and retain employees through the flexibility of exemption from the SPA or within the SPA but through updated market analysis.
- 2) **All subsections are independent of each other** but may reference ties to each other. *[Emphasis Added]*
  - a. Subsection (a) is exempt from SPA [State Personnel Act] as described to include class and comp rules. **It is my opinion that this subsection will not be utilized that much.** *[Emphasis Added]*
  - b. Subsection (b) is stating that if an employee has already achieved career status then they can keep it even if the[y] voluntary select subsection (a)
  - c. Subsection (c) **states that we can only use up to 2% of appropriations from the Highway Fund and Highway Trust Fund for Salary adjustments**, reallocations, recruitments and retention programs through data collection and analysis. It is my opinion that actions taken under this subsection can be subject to SPA. *[Emphasis Added]*

The COO also wrote:

I hope we get a chance to discuss. After the legislation passed, I asked our legal team to review. **We all agree that the legislation could have been written a little clearer** but overall my team agrees with my interpretation. *[Emphasis Added]*

Despite concerns about the legislation's clarity, the Department did not consult with the Joint Legislative Transportation Oversight Committee or the General Assembly's Fiscal Research Division.

### **State Law Set Conditions on Salary Adjustments**

In exchange for receiving salary adjustments that were exempt from state compensation rules, Section 34.19 of Session Law 2018-5 required Department employees who received the salary adjustments to relinquish claims to longevity pay and career status.

Specifically, the law stated: *[Emphasis Added]*

SECTION 34.19.(a). Subject to the approval of the Secretary of the Department of Transportation, **employees** of the Department of Transportation (Department) **who voluntarily relinquish** (i) annual longevity payments or **any claim to longevity pay** and (ii) **any claim to career status** or eligibility for career status **are exempt from:**

- (1) The classification and **compensation rules established by the State Human Resources Commission** pursuant to G.S. 126 4(1) through (4).

Additionally, Session Law 2018-5 limited the total amount of salary adjustments to two percent of the Department's payroll expense.

Specifically, the law stated: [*Emphasis Added*]

SECTION 34.19.(c). For the 2018 2019 fiscal year and the 2019 2020 fiscal year, **the sum equal to two percent (2%) of the total Highway Fund and Highway Trust Fund appropriation for the applicable fiscal year for the payroll expenses of the Department may be used for the purposes of:**

- (1) **Salary adjustments** within the Department to provide competitive salary rates and to address changes in labor market salary rates as documented through the Department's data collection and analysis according to accepted human resource professional practices and standards.

Auditors confirmed these requirements through interviews with members of the Joint Legislative Transportation Oversight Committee and the General Assembly's Fiscal Research Division.

## RECOMMENDATIONS

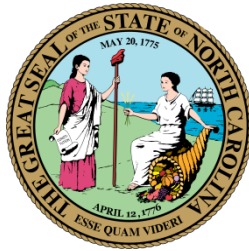
The Department should consult with appropriate legislative bodies to determine the intent of state laws before implementing programs.

The Department should consider taking corrective action to bring the Department into compliance with Session Law 2018-5.

The Joint Legislative Transportation Oversight Committee should determine whether Department management performed appropriate due diligence to ensure the intent of Session Law 2018-5 was met and take appropriate action if not.

## AGENCY RESPONSE

See page 21 for the Department's response to this finding.



# **MATTERS FOR FURTHER CONSIDERATION**

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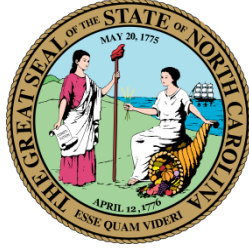
**DEPARTMENT SHOULD OBTAIN GUIDANCE BEFORE ADJUSTING DMV SALARIES**

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The Department of Transportation (Department) should obtain clarification about the legislative intent of Section 34.19 of Session Law 2018-5 before making salary adjustments for the Division of Motor Vehicles (DMV).

DMV was not included in the initial salary adjustments that the Department made under Session Law 2018-5. A labor market study is currently in process that will be used as a basis for determining future salary adjustments.

Clarification from the Joint Legislative Transportation Oversight Committee and the General Assembly's Fiscal Research Division will help ensure that the Department properly implements the DMV salary adjustments.



# APPENDIX A

## PILOT PROGRAM/DOT SALARY ADJUSTMENT & RETENTION FUNDS

SECTION 34.19.(a) Subject to the approval of the Secretary of the Department of Transportation, employees of the Department of Transportation (Department) who voluntarily relinquish (i) annual longevity payments or any claim to longevity pay and (ii) any claim to career status or eligibility for career status are exempt from:

- (1) The classification and compensation rules established by the State Human Resources Commission pursuant to G.S. 126 4(1) through (4).
- (2) G.S. 126 4(5) only as it applies to hours and days of work, vacation, and sick leave.
- (3) G.S. 126 4(6) only as it applies to promotion and transfer.
- (4) G.S. 126 4(10) only as it applies to the prohibition of the establishment of incentive pay programs.
- (5) Article 2 of Chapter 126 of the General Statutes, except for G.S. 126 7.1.

SECTION 34.19.(b) Nothing in subsection (a) of this section shall be construed to abrogate career status under G.S. 126 1.1.

SECTION 34.19.(c) For the 2018 2019 fiscal year and the 2019 2020 fiscal year, the sum equal to two percent (2%) of the total Highway Fund and Highway Trust Fund appropriation for the applicable fiscal year for the payroll expenses of the Department may be used for the purposes of:

- (1) Salary adjustments within the Department to provide competitive salary rates and to address changes in labor market salary rates as documented through the Department's data collection and analysis according to accepted human resource professional practices and standards.
- (2) Reallocation of positions within the Department to higher level job classifications to compensate employees for more difficult duties at competitive salary rates as documented through data collection and analysis according to accepted human resource professional practices and standards.
- (3) Recruitment and retention programs instituted at the Secretary's discretion.

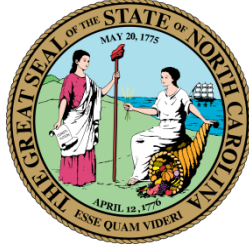
SECTION 34.19.(d) Priority funding shall be given to recruitment, retention, salary range revisions, and reallocations affecting the job classifications and bands deemed by the Secretary to be most in need of immediate attention. The Department, as determined by the Department to be needed, may utilize market surveys and other relevant employment sector information available to the Office of State Human Resources.

SECTION 34.19.(e) The Department shall report to the Joint Legislative Transportation Oversight Committee and Fiscal Research Division of the General Assembly, beginning January 1, 2019, and the semiannually thereafter, regarding the actions taken pursuant to this section.

SECTION 34.19.(f) Notwithstanding G.S. 126 7.1 or any law to the contrary, the Secretary of the Department of Transportation may designate vacant positions as not being subject to the open recruitment requirements of G.S. 126 7.1(a) for the purpose of carrying out the recruitment flexibility granted to the Secretary under subdivision (3) of subsection (c) of this section. The Secretary shall notify the State Human Resources Commission within 30 days of invoking recruitment flexibility.

SECTION 34.19.(g) Compensation decisions made under this section are exempt from the classification and compensation rules and policies established by the State Human Resources Commission.

SECTION 34.19.(h) This section becomes effective July 1, 2018, and expires June 30, 2020.



# APPENDIX B



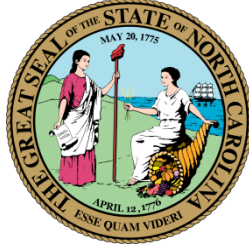
### **Internal Control Components and Principles Significant to the Audit Objective**

Our audit objective was to determine whether the Department of Transportation made 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5.

Internal control components and underlying principles that were significant to our audit objective are identified in the table below.

	Audit Objective
<b>Control Environment</b>	
1. The oversight body and management should demonstrate a commitment to integrity and ethical values.	X
2. The oversight body should oversee the entity's internal control system.	
3. Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives.	
4. Management should demonstrate a commitment to recruit, develop, and retain competent individuals.	
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.	
<b>Risk Assessment</b>	
6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.	
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.	
8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.	
9. Management should identify, analyze, and respond to significant changes that could impact the internal control system.	
<b>Control Activities</b>	
10. Management should design control activities to achieve objectives and respond to risks.	X
11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.	
12. Management should implement control activities through policies.	

<b>Information and Communication</b>	
13. Management should use quality information to achieve the entity's objectives.	X
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.	
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.	X
<b>Monitoring Activities</b>	
16. Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.	
17. Management should remediate identified internal control deficiencies on a timely basis.	



# **STATE AUDITOR'S RESPONSE**

The Office of the State Auditor (OSA) is required to provide additional explanation when an agency's response could potentially cloud an issue, mislead the reader, or inappropriately minimize the importance of the auditor findings.

*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.

In its response, **the Department** of Transportation (Department) made inaccurate and misleading statements and **generally argued that the audit findings are based on OSA's misinterpretation of Section 34.19 of Session Law 2018-5**. To ensure the availability of complete and accurate information, and in accordance with *Generally Accepted Government Auditing Standards*, OSA offers the following clarifications.

#### **Department Response to Finding That Salary Increases Are Linked to Waiver of Rights**

The Department's response could mislead readers to believe that **OSA interpreted** the law and reported its own determination that Department employees were required to relinquish longevity and career status in exchange for salary adjustments. The Department wrote:

**This audit report erroneously interprets this law** by reading these subsections to be completely interdependent. Specifically, **the audit report incorrectly interprets the law** to require that any salary adjustments made pursuant to Section 34.19(c) be premised on an employee relinquishing certain rights outlined in Section 34.19(a). [*Emphasis Added*]

#### **OSA did not interpret the law.**

OSA reported the intent of the law as it was stated to auditors by members of the Joint Legislative Transportation Oversight Committee (Committee) and the General Assembly's Fiscal Research Division (Fiscal Research). The members stated that the intent of the law was to require Department employees to relinquish longevity and career status in exchange for salary adjustments that were exempt from state compensation rules.

OSA also reported the intent of the law as it is summarized and documented in the **May 29, 2018, Joint House and Senate Committee on Appropriations Conference Report on Senate Bill 99, Appropriations Act of 2018** meeting minutes that state:

Provision 7 is a pilot program. It allows DOT flexibility for a period of two years in setting salaries **for DOT employees who voluntarily relinquish longevity and career status**. It also enables DOT to use up to two percent or \$11.7 million per payroll for the purpose of salary adjustments, reallocation of positions, retention and recruitment programs. [*Emphasis Added*]

Committee members, Fiscal Research members, the report, and the meeting minutes were all available to the Department before it made salary adjustments between **August 11, 2018**, and **December 1, 2018**.

The Department also made multiple statements that could mislead the reader to believe that the Department has an official interpretation of the law. For example, the Department states:

**The law does not require, and the legislature did not intend** to require, that any employee receiving a market rate salary adjustment pursuant to this pilot program forego career status and longevity pay. [*Emphasis Added*]

To the contrary, the Department has **NO formal opinion** from anyone to support its interpretation of the law.

The Department's interpretation is just that – the Department's interpretation. It's an interpretation developed by Department management (Chief Operating Officer, Interagency Director, and former Secretary) in consultation with its legal team.

The Department also consulted with its representative at the Attorney General's Office (AG) but did not ask for or receive a formal opinion. In an email dated June 13, 2018, the AG representative wrote:

I hope these thoughts are helpful to you. Note that they are mine alone and are **not approved in accordance with the procedures for an official opinion** of the Department of Justice. [*Emphasis Added*]

Still, the AG representative's email discussed the law as a single "program" and offered the following suggestion for implementation:

Sometimes, posting and open recruitment are the best ways to get a well-qualified applicant pool; picking and choosing from among those **who elect to (waive their rights and) participate in the program** may actually yield fewer well-qualified candidates. I guess I am saying to strive for a balance between a quick turnaround under this "program" and a defensible, transparent program. [*Emphasis Added*]

The Department did not follow the AG representative's suggestion. In a report dated July 1, 2019, the Secretary stated that he did not approve any employees to voluntarily relinquish longevity or career status. However, the report failed to mention that the Department never presented the option to its employees.

The Department also misleads readers to believe that section 34.19(a) was only meant to attract and retain a select number of candidates. The Department states:

Section 34.19(a) is intended to provide a mechanism for the Department to **attract and retain a select number of candidates** by removing various restrictions on classification and compensation in exchange for giving up claims to career status and longevity pay. [*Emphasis Added*]

However, the first line of 34.19(a) refers to "**employees** of the Department of Transportation." Consequently, the program broadly and directly addressed those who already worked there.

### **Department Response to Finding That Salary Increase Limited to Two Percent of Payroll Expenses**

The Department's response could mislead the reader to believe that **OSA interpreted** the law and reported its own determination that salary adjustments were limited to 2% of payroll expense. The Department wrote:

**The audit contends** that the allocation provided in Section 34.19(c) is limited to 2% of payroll expenses. *[Emphasis Added]*

Again, **OSA did not interpret the law.**

OSA reported the intent of the law as it was stated to auditors by Committee and Fiscal Research members. The members stated that the intent of the law was to limit salary adjustments to 2% of annual payroll expense.

OSA also reported the intent of the law as it is summarized and documented in the **May 29, 2018, Joint House and Senate Committee on Appropriations Conference Report on Senate Bill 99, Appropriations Act of 2018** meeting minutes that state:

Provision 7 is a pilot program. It allows DOT flexibility **for a period of two years** in setting salaries for DOT employees who voluntarily relinquish longevity and career status. It also enables DOT to **use up to two percent or \$11.7 million per payroll** for the purpose of salary adjustments, reallocation of positions, retention and recruitment programs. *[Emphasis Added]*

It should be noted that not only was the 2018 conference report clear about the 2% limit, but the report even stated that the amount would be \$11.7 million per payroll. The stated \$11.7 million limit is inconsistent with the Department's interpretation that the intent of the law was to allow the Department to use 2% of its total appropriation for salary adjustments.

The Department acknowledged a lack of clarity about the intent of the law and that the Department acted on its own interpretation. The Department stated:

**Admittedly, Section 34.19(c) is not a model in statutory construction. But the Department's interpretation - that the allocation is 2% of the total appropriation** - is consistent with discussions with the legislature both before and after the passage of Session Law 2018-5. *[Emphasis Added]*

But the Department did not consult with Committee or Fiscal Research members to obtain clarity about the intent of the law. Furthermore, the Department has **no formal opinion** from anyone to support its interpretation of the law, regardless of whether or not it believes its interpretation is consistent with discussions with the Legislature.

### Department Response to Other Analysis Included in the Audit Report

The Department's response inaccurately states that this audit says the Department did not receive input from the Legislature. The Department states:

The Department disputes **the audit's contention that the Department executed the pilot program without input from the legislature.** The Department worked with the legislature during the development of this pilot program. [*Emphasis Added*]

**This audit reported no such issue.**

This audit clearly and specifically stated that, when the Department was unclear about how to interpret the law, the Department failed to consult with Committee and Fiscal Research members to understand the intent of the law.

Additionally, by stating that the Department "continued conversations with the legislature" the Department's response could mislead readers to believe that the Department sought the Legislature's interpretation. The Department wrote:

Though it is not the role of a legislative body to interpret the laws it enacts, **the Department continued conversations with the legislature** during the implementation of the pilot program while, at the same time, consulting with counsel for interpretations of law.

The reader should be clear that, while the Department may have had conversations with the Legislature, the Department did not ask the Legislature how to interpret the law. Instead, Department management consulted its legal team and developed its own interpretation of the law as documented in the Department's July 3, 2018, email from the Chief Operating Officer to the Office of State Human Resources:

I hope we get a chance to discuss. After the legislation passed, **I asked our legal team to review.** We all agree that the legislation could have been written a little clearer but overall **my team agrees with my interpretation.** [*Emphasis Added*]

The Department's response could mislead readers to believe that the Legislature agrees with the Department's interpretation of the law because the Legislature has not taken corrective action.

If the interpretation and implementation of Section 34.19 of Session Law 2018-5 was inconsistent with the law or the intent of the legislature, the legislature has had numerous opportunities to change the law or otherwise direct the Department to take corrective action. The legislature has issued no such directive.

However, the Department's response ignores multiple news articles where legislators have publicly disagreed with the Department's interpretation and implementation of the law. The fact that the Legislature has not taken corrective action does not mean that the Department properly interpreted and implemented the law.

The Department's response inaccurately states that the audit findings exceeded the scope of an audit. The Department wrote:

Finally, **the Department finds elements of the audit's key findings**, which are based solely on an interpretation of law that differs from the Department, **to be beyond the objective intent of an audit. A declaration that the Department's implementation of the pilot program provided an "unfair advantage"** over other state agencies **is a subjective policy pronouncement.** *[Emphasis Added]*

All elements of the audit findings complied with *Generally Accepted Government Auditing Standards*.

The standards **explicitly** establish compliance objectives such as **determining whether a program was conducted in accordance with laws and regulations** as a performance audit objective. Our audit objective was a compliance audit objective.

The standards also require auditors to report the **effect** – the outcome or consequence – of their findings. This audit reported **three effects** of the Department's noncompliance, the first of which was the negative impact on the Office of State Human Resources' stated objective of having **"a pay system that is fair and equitable."** The law as written would have maintained equity. The Department chose to implement the law in a way that did not.

Similarly, the Department's response takes issue with the second **effect** reported in this audit. The Department wrote:

Similarly, **the finding that the Department faced no repercussions** for implementing the policy in a manner that did not comply with the State Auditor's interpretation... The audit's characterization of the interplay between the legislature and the Department **is a statement of advocacy rather than an objective finding of an audit.** *[Emphasis Added]*

Again, audit standards require auditors to report the **effect** – the outcome or consequence – of their findings. The second effect concerns the control environment - the foundational discipline and structure that affects the overall quality of internal control. The Government Accountability Office states:

The oversight body and management set the **tone at the top** and throughout the organization **by their example**, which is fundamental to an effective internal control system. *[Emphasis Added]*

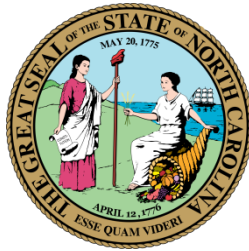
The audit finding's second **effect** properly reports on the negative impact that lack of repercussions to the Department has on the State's control environment.

Lastly, the Department's response could mislead readers to believe that the Department has achieved the goals of the program.

**The primary purpose of this pilot program was to allow the Department to compete with private industry for highly skilled employees.** To date and in spite of recent financial challenges, **the Department has been able to retain and attract valued employees** despite continued competition from private industry. *[Emphasis Added]*



Readers should know that no audit has been performed to obtain objective, independent evidence that the Department has retained or attracted more employees or that any retention or attraction was actually the result of the program. This audit only evaluated whether the Department implemented the program in accordance with the law. **The Department did not.**



# **RESPONSE FROM DEPARTMENT OF TRANSPORTATION**



STATE OF NORTH CAROLINA  
DEPARTMENT OF TRANSPORTATION

ROY COOPER  
GOVERNOR

J. ERIC BOYETTE  
SECRETARY

The Honorable Beth A. Wood  
State Auditor  
20601 Mail Service Center  
Raleigh, NC 27699-0600

Dear Auditor Wood:

Thank you for providing the Department of Transportation the opportunity to respond to the performance audit entitled *Department of Transportation, Salary Adjustments*. The Department disputes the findings of this performance audit report and believes that the findings of this audit are premised on a misinterpretation of law and a misunderstanding of the pilot program established by Section 34.19 of Session Law 2018-5. The Department is confident that it executed this pilot program in conformance with law and in a manner that fulfilled the intent of the legislature. Please find a more detailed response from the Department in the attached memorandum.

Though the Department disputes the findings of this audit, we appreciate the time and professionalism of you and your staff in completing this audit. Please let us know if you have additional questions or need additional information.

Sincerely,  
Handwritten signature of J. Eric Boyette in blue ink, with the initials "JE" and "ES" written below it.

J. Eric Boyette  
Secretary

Mailing Address:  
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Customer Service: 1-877-368-4968

Website: [ncdot.gov](http://ncdot.gov)

Location:  
1 SOUTH WILMINGTON STREET  
RALEIGH, NORTH CAROLINA 27601

Date: June 15, 2020

From: J. Eric Boyette, Secretary  
Department of Transportation

To: Beth Wood, State Auditor  
Office of the State Auditor

SUBJ: RESPONSE TO AUDIT -- DEPARTMENT OF TRANSPORTATION SALARY ADJUSTMENTS

Audit Finding: "The Department did not make 2018-2019 state fiscal year salary adjustments in accordance with Section 34.19 of Session Law 2018-5. Department employees received salary adjustments that did not comply with state compensation rules, but the employees did not relinquish claims to longevity and career status as required by state law. Additionally, the total amount of salary adjustments exceeded the two-percent-of-payroll-expense limit."

Department Response To Finding That Salary Increases Are Linked To Waiver of Rights

Section 34.19 of Session Law 2018-5 is composed of eight subsections, 34.19(a) through 34.19(h). This audit report erroneously interprets this law by reading these subsections to be completely interdependent. Specifically, the audit report incorrectly interprets the law to require that any salary adjustments made pursuant to Section 34.19(c) be premised on an employee relinquishing certain rights outlined in Section 34.19(a). These two sections are not intended to be read together and, instead, provide two independent components of the pilot program. Section 34.19(a) is intended to provide a mechanism for the Department to attract and retain a select number of candidates by removing various restrictions on classification and compensation in exchange for giving up claims to career status and longevity pay. Section 34.19(c) is designed to provide the Department with the ability to adjust salaries broadly to match market rates within an established classification and compensation structure. Section 34.19(g) exempts the salary adjustments made pursuant to Section 34.19(c) from the classification and compensation rules and policies of the State Human Resources Commission. If the salary adjustments made pursuant to Section 34.19(c) were contingent upon the exemptions in Section 34.19(a), Section 34.19(g) would be superfluous; its existence confirms the Department's position that Section 34.19(a) and Section 34.19(c) are not contingent sections. The law does not require, and the legislature did not intend to require, that any employee receiving a market rate salary adjustment pursuant to this pilot program forego career status and longevity pay.

Department Response To Finding That Salary Increase Limited To Two Percent of Payroll Expenses

The Department further disputes the audit's contention that the Department overspent in making salary adjustments. The Department interpreted Section 34.19(c) to authorize the expenditure of 2% of the total Highway Fund and Highway Trust Fund appropriation on salary adjustments, reallocation of positions, and recruitment. The audit contends that the allocation provided in Section 34.19(c) is limited to 2% of payroll expenses. Admittedly, Section 34.19(c) is not a model in statutory construction. But the Department's interpretation – that the allocation is 2% of the total appropriation – is consistent with discussions with the legislature both before and after the passage of Session Law 2018-5. Adjustments to salaries that amount to two percent of the Department's payroll expenses could have been accomplished via salary adjustments within the existing compensation structure and without specific statutory authorization. But such adjustments would have been insufficient to accomplish the market-based recruitment and retention goals of the pilot program. Furthermore, the legislature does not specifically appropriate payroll expenses for the Department. The Department's payroll expenses are a mix of administrative positions that are a component of the

authorization for administrative expenses and field positions that bill against Department projects. There is no specific appropriation for “payroll”. Interpreting Section 34.19(c) to be limited to two percent of payroll rather than two percent of total Highway Fund and Highway Trust Fund authorization simply does not make sense when interpreted with all of Section 34.19 and DOT budget authority.

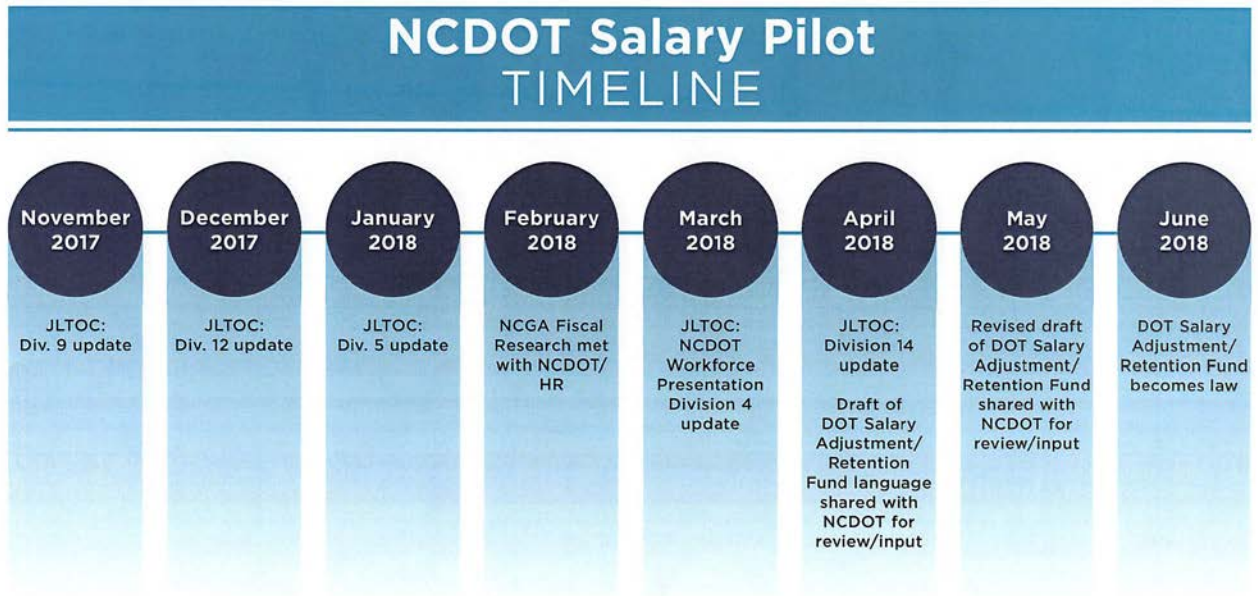
Department Response To Other Analysis Included In The Audit Report

The Department disputes the audit’s contention that the Department executed the pilot program without input from the legislature. The Department worked with the legislature during the development of this pilot program. Though it is not the role of a legislative body to interpret the laws it enacts, the Department continued conversations with the legislature during the implementation of the pilot program while, at the same time, consulting with counsel for interpretations of law. Following implementation of the program, the Department reported to the legislature on the implementation and impact of the pilot program. If the interpretation and implementation of Section 34.19 of Session Law 2018-5 was inconsistent with the law or the intent of the legislature, the legislature has had numerous opportunities to change the law or otherwise direct the Department to take corrective action. The legislature has issued no such directive.

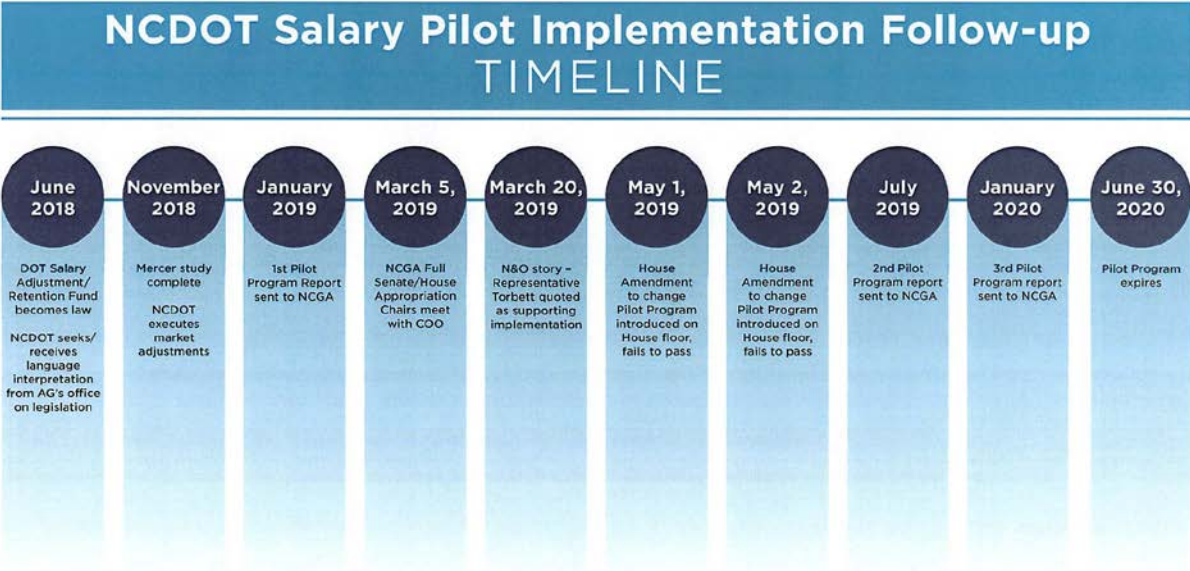
Finally, the Department finds elements of the audit’s key findings, which are based solely on an interpretation of law that differs from the Department, to be beyond the objective intent of an audit. A declaration that the Department’s implementation of the pilot program provided an “unfair advantage” over other state agencies is a subjective policy pronouncement. Even implementation of the program in accordance with the interpretation of the Office of the State Auditor would have provided the Department with an “unfair advantage”. The critique that this program provided an “unfair advantage” to the Department is an argument against the concept of the pilot program rather than an objective critique of the implementation of the program by the Department.

Similarly, the finding that the Department faced no repercussions for implementing the policy in a manner that did not comply with the State Auditor’s interpretation of Section 34.19 of Session Law 2018-5 and thereby demonstrated that an agency can act independently from legislative direction without consequence ignores the many tools available to the legislature to modify the behavior of an agency and the fact that the legislature reviewed this program implementation on several occasions and took no such action. The audit’s characterization of the interplay between the legislature and the Department is a statement of advocacy rather than an objective finding of an audit.

The primary purpose of this pilot program was to allow the Department to compete with private industry for highly skilled employees. To date and in spite of recent financial challenges, the Department has been able to retain and attract valued employees despite continued competition from private industry.







# ORDERING INFORMATION

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For additional information, contact the  
North Carolina Office of the State Auditor at 919-807-7666.



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This audit required 941.5 hours of auditor effort at an approximate cost of \$97,916.