

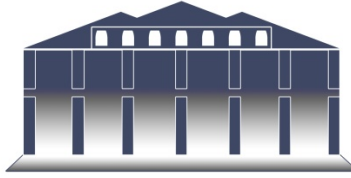
**Department of Transportation and Council of
Internal Auditing Did Not Ensure DOT Compliance
with Internal Audit Act**



**Final Report to the Joint Legislative
Program Evaluation Oversight Committee**

Report Number 2020-08

August 10, 2020



Program Evaluation Division
North Carolina General Assembly
Legislative Office Building, Suite 100
300 North Salisbury Street
Raleigh, NC 27603-5925
919-301-1404
www.ncleg.net/PED

75 copies of this public document were printed at a cost of \$63.15 or \$0.84 per copy.

A limited number of copies are available for distribution through the Legislative Library:

Rooms 2126, 2226
State Legislative Building
Raleigh, NC 27601
919-733-7778

Room 500
Legislative Office Building
Raleigh, NC 27603
919-733-9390

The report is also available online at www.ncleg.net/PED.



NORTH CAROLINA GENERAL ASSEMBLY
Legislative Services Office

Paul Coble, Legislative Services Officer

Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925
Tel. 919-301-1404 Fax 919-301-1406

John W. Turcotte
Director

August 10, 2020

Senator Brent Jackson, Co-Chair, Joint Legislative Program Evaluation Oversight Committee
Representative Craig Horn, Co-Chair, Joint Legislative Program Evaluation Oversight Committee

North Carolina General Assembly
Legislative Building
16 West Jones Street
Raleigh, NC 27601

Honorable Co-Chairs:

The Joint Legislative Program Evaluation Oversight Committee's 2019–20 Work Plan directed the Program Evaluation Division to examine the efficiency and effectiveness of the internal audit program of the Department of Transportation (DOT) and oversight of the program by the department and by the Council of Internal Auditing.

I am pleased to report that DOT cooperated with us fully and was at all times courteous to our evaluators during the evaluation.

Sincerely,

A handwritten signature in black ink, appearing to read "John W. Turcotte".

John W. Turcotte
Director

Mandatory Evaluation Components

Report No. 2020-08, Department of Transportation and Council of Internal Auditing Did Not Ensure DOT Compliance with Internal Audit Act

N.C. Gen. § 120-36.14 requires the Program Evaluation Division to include certain components in each of its evaluation reports, unless exempted by the Joint Legislative Program Evaluation Oversight Committee. The table below fulfills this requirement and, when applicable, provides a reference to the page number(s) where the component is discussed in the report.

N.C. Gen. § 120-36.14 Specific Provision	Component	Program Evaluation Division Determination	Report Page
(b)(1)	Findings concerning the merits of the program or activity based on whether the program or activity		
(b)(1)(a)	Is efficient	The Department of Transportation's Office of Inspector General (DOT OIG) is not efficient based on measuring reports produced per budgetary resources. Although DOT OIG's budget has been stable, production of reports that meet standards is minimal and in decline. The OIG's self-assessment states that it only "Partially Meets" the standard of having performance measures that assess efficiency/process.	24
(b)(1)(b)	Is effective	Performance measures assess key outcomes. Overall, DOT OIG is not effective because its audits result in few reports and are not focused on areas of department-wide and strategic significance. The OIG is also not measuring accomplishments or improvement attributable to its audits.	24
(b)(1)(c)	Aligns with entity mission	The majority of work DOT OIG actually performs, which the office termed "compliance" auditing, does not align with its charter. DOT OIG's "compliance" work consists of prepayment approval, which violates independence standards for internal auditors and is a management rather than an internal audit function.	13
(b)(1)(d)	Operates in accordance with law	DOT OIG is not violating the law, yet it is not producing audits, particularly performance audits, that are consistent with audit standards mandated by state law. DOT, the Council of Internal Auditing, and the State Board of Transportation are not ensuring compliance with the standards required by the Internal Audit Act.	1,8,15
(b)(1)(e)	Does not duplicate another program or activity	The Program Evaluation Division did not find that the Office of Inspector General function at the Department of Transportation duplicates any other program or activity.	N/A
(b)(1a)	Quantitative indicators used to determine whether the program or activity		
(b)(1a)(a)	Is efficient	DOT OIG should but does not measure efficiency based on cost per audit hour and the number of internal audit reports issued compared to planned internal audits. The OIG tracks staff turnover/retention as one measure of efficiency.	24
(b)(1a)(b)	Is effective	DOT OIG should but does not measure effectiveness based on the number of significant audit findings and recommendations produced and results achieved by the number and percentage of significant recommendations implemented within DOT.	24

(b)(1b)	Cost of the program or activity broken out by activities performed	The Program Evaluation Division estimates that it costs the State about \$2.7 million each year to operate DOT OIG.	6
(b)(2)	Recommendations for making the program or activity more efficient or effective	<p>1. The State Board of Transportation Audit Committee should revisit its annual audit plan and determine why DOT OIG is not publishing reports. Completed reports from the annual audit plan should be a dashboard item at each monthly meeting of the Board of Transportation.</p> <p>2. The Council of Internal Auditing should conduct an investigative hearing on DOT internal audit functions, receive testimony from DOT and independent experts, and recommend corrective actions to DOT and the General Assembly.</p> <p>3. The General Assembly should:</p> <ul style="list-style-type: none"> • direct DOT and the Council of Internal Auditing to work jointly on a general overhaul of DOT OIG to improve its effectiveness and enhance its independence by ensuring OIG engagements do not blur boundaries of management activities; • require the Council of Internal Auditing to establish a minimum level of performance audit effort in compliance with standards for agency internal audit units; • require Council staff to periodically examine a stratified sample of internal auditing reports and annual plans for conformity and report deficiencies to the Council; • require the Council to review every external quality assurance review for each agency internal audit function, hold hearings on any reported deficiencies, and monitor corrective action; and • upon request by a resolution approved by the Council of Internal Auditing defining requirements, consider providing funding for the Council to contract with experts to perform more complex reviews of audit units and provide expertise on internal auditing operations, standards, and technology. <p>The General Assembly should require that all actions be implemented by June 1, 2021.</p>	16
(b)(2a)	Recommendations for eliminating any duplication	The Program Evaluation Division did not find evidence of duplication.	N/A
(b)(4)	Estimated costs or savings from implementing recommendations	Costs will be associated with providing additional funding for the Council of Internal Auditing to establish a minimal level of performance auditing within state agencies and to contract with experts to perform more complex reviews and provide expertise. The costs may be offset by savings and efficiencies achieved through conducting more performance audits in agencies if the audits are done in accordance with standards.	N/A

Contents

Page

Findings 8

Recommendations 16

Appendices 18

Department of Transportation Response 26

Council of Internal Auditing Response 28

State Auditor Response 30



PROGRAM EVALUATION DIVISION

NORTH CAROLINA GENERAL ASSEMBLY

August 2020

Report No. 2020-08

Department of Transportation and Council of Internal Auditing Did Not Ensure DOT Compliance with Internal Audit Act

Highlights

IN BRIEF: Despite its internal audit unit being the second largest among state agencies, the Department of Transportation (DOT) has not maintained a robust and viable internal audit effort. DOT's Office of Inspector General (DOT OIG) has not produced a performance audit since 2016. Performance audits could have detected and preempted severe DOT budget and cash control problems recently confirmed by the State Auditor. Further, the Council of Internal Auditing is not conducting compliance examinations of agency internal audit work products. Such an examination of DOT OIG by the Council could have identified problems and recognized omissions and deficiencies by comparing OIG work products to standards established by the Internal Audit Act of 2007.

BACKGROUND: Following a highly critical 2006 State Auditor report that found internal auditing deficiencies in nearly every state agency, the General Assembly enacted the 2007 Internal Audit Act, which requires large agencies including DOT to maintain internal audit units. DOT OIG conducts the department's internal auditing with 23 positions and a \$2.7 million budget. Units must follow professional standards under the guidance and oversight of the Council of Internal Auditing created by the Act. The Council has subpoena power and may conduct hearings to determine the effectiveness of any internal audit unit.

The internal audit function performed by DOT's Office of Inspector General (DOT OIG) is ineffective, delivering work products that do not conform to standards required by state law.

Since 2016, DOT OIG has not produced a single performance audit, which is a type of audit that could have identified DOT overspending and cash flow problems that began to surface in 2018 and that the State Auditor confirmed in a 2020 report. Instead, over 71% of DOT OIG's work products in Fiscal Year 2018–19 were contractor overhead/cost review approvals of the type ordinarily performed by a controller's office. DOT OIG did not conduct any financial, follow-up, information systems, or integrated audits in Fiscal Year 2018–19. Deficiencies stem from a failure by DOT management, the State Board of Transportation, and the Council of Internal Auditing to recognize and correct DOT internal audit deficiencies as identified by external peer reviews and made evident by DOT internal audit filings and reports.

Recommendation 1. The General Assembly should direct the State Board of Transportation Audit Committee to revisit DOT OIG's annual audit plan and determine why DOT OIG is not publishing reports.

Recommendation 2. The General Assembly should direct the Council of Internal Auditing to conduct a hearing on DOT internal audit functions and assist DOT in improving the effectiveness of OIG.

Recommendation 3. The General Assembly should direct the Council of Internal Auditing to establish and monitor compliance with standards for all state agency internal audit units.

To that end, the Council of Internal Auditing should

- establish a minimum level of performance audit effort in compliance with standards for agency internal audit units;
- periodically examine a stratified sample of internal auditing reports and annual plans for conformity and report deficiencies; and
- review every external quality assurance review for each agency internal audit function, hold hearings on any reported deficiencies, and monitor corrective action.

If the Council approves a resolution defining requirements, the General Assembly should consider providing funding for the Council to contract with experts to perform more complex reviews of audit units and provide expertise on internal auditing operations, standards, and technology.

Purpose and Scope

The Joint Legislative Program Evaluation Oversight Committee's 2019–20 Work Plan directed the Program Evaluation Division to examine the efficiency and effectiveness of the internal audit program of the Department of Transportation (DOT) and oversight of the program by the department and by the Council of Internal Auditing. The Program Evaluation Division also considered to what extent the DOT internal auditing process may have contributed to a failure to detect and preempt DOT cash surpluses followed by shortfalls and financial management problems as confirmed by a national consulting firm and reported by the State Auditor in May 2020.

Five research questions guided this evaluation:

1. What is internal auditing and what are its requirements?
2. How is DOT's internal auditing program organized, funded, and administered?
3. Is the DOT internal audit program operating in compliance with state law and applicable standards established in accordance with state law?
4. Is the DOT internal auditing program efficient?
5. Is the DOT internal auditing program effective?

The Program Evaluation Division collected and reviewed data and information from several sources, including

- review of laws and policies governing internal auditing functions at North Carolina state agencies;
- review of professional literature on internal auditing;
- queries of DOT's Office of Inspector General (DOT OIG);
- review of data obtained from DOT OIG; and
- interviews with officials from DOT OIG.

Background

The State Internal Audit Act of 2007 mandated that agencies with internal audit units adhere to standards as outlined by professional organizations and publications. Standards include the Institute of Internal Auditors's (IIA) *International Professional Practices Framework* (known as the Red Book) as well as the U.S. Government Accountability Office's *Government Auditing Standards* (known as the Yellow Book).

The Institute of Internal Auditors defines internal auditing as follows:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Appendix A provides definitions of risk management, control, and governance processes along with other accounting and auditing terms relevant to this report.

Risk assessment is an essential element of internal auditing and is required by the *International Standards for the Professional Practice of Internal Auditing*:

Standard 2010.A1 – The internal audit activity’s plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

In 2006, the North Carolina Office of the State Auditor reported that internal auditing was deficient at state agencies and that many internal auditors were unqualified or were not performing genuine internal audit work. As shown in Exhibit 1, amongst several findings applicable to multiple state agencies, one of the auditor’s findings was specific to DOT.¹ Appendix B provides DOT’s official response to the audit.

Exhibit 1: Among Several Generally Applicable Findings, 2006 State Auditor Report on Internal Auditing in State Government Directed One Finding at DOT Internal Audit

State Government-Wide Findings

North Carolina state government and its institutions lack sufficient internal audit policies.

Internal audit organizations are not obtaining quality assurance reviews by outside parties.

Some internal audit sections did not report to the highest management level within the organization.

Some internal audit organizations did not execute an annual audit plan while others did not perform risk assessments to develop an audit plan.

Finding Specific to DOT Internal Audit Section

DOT experienced significant difficulties with completing audits and producing audit reports.

Source: Program Evaluation Division based on the North Carolina Office of the State Auditor’s Internal Auditing in North Carolina Agencies and Institutions, September 2006.

As a result of the Auditor’s 2006 report, the Joint Select Government Performance Audit Committee (GPAC II) studied state government-wide management, including internal auditing, and contracted with MGT of America to propose a remedial plan specific to internal auditing.^{2,3} GPAC II responded by recommending reform legislation, which became the North Carolina Internal Audit Act of 2007.⁴ The Act

- requires establishment of an internal audit unit within any state agency that has an annual operating budget exceeding \$10 million, has more than 100 full time employees, or receives and processes more than \$10 million in cash in a fiscal year;

¹ North Carolina Office of the State Auditor *Internal Auditing in North Carolina Agencies and Institutions*, September 2006. Retrieved from <https://www.auditor.nc.gov/EPSSWeb/Reports/Performance/PER-2006-7216.pdf>

² Joint Select Government Performance Audit Committee II. (2007, May). TPACT, LLC’s *Progress Report of Joint Select Government Performance Audit Committee December 2006 through May 17, 2007: Status Report and Potential Program Evaluation Topics*. Raleigh, NC: General Assembly.

³ Joint Select Government Performance Audit Committee II. (2007, May). MGT of America, Inc.’s *Establishing an Internal Audit Program in North Carolina’s State Agencies*. Raleigh, NC: General Assembly. Retrieved from <https://www.ncleg.gov/PED/Reports/2008/InternalAudit.html>.

⁴ N.C. Gen. Stat. § 143-745 through § 143-749.

- created the Council of Internal Auditing, an ex officio body within the Office of State Budget and Management which consists of the State Controller, State Budget Officer, Secretary of Administration, Attorney General, Secretary of Revenue, and the State Auditor as a non-voting member; and
- requires the Council to hold meetings at the call of the Chair or upon written request to the Chair by two members of the Council. Specific duties of the Council are presented in Exhibit 2.

Exhibit 2: Council of Internal Auditing Assigned Several Duties in Effort to Help Remedy Deficiencies Identified in 2006 Auditor Report

Council of Internal Auditing Duties
Promulgate guidelines for the uniformity and quality of state agency internal audit activities
Recommend the number of internal audit employees required by each state agency
Develop internal audit guides, technical manuals, and suggested best practices
Administer an independent peer review system for each state agency internal audit activity, specify the frequency of such reviews consistent with applicable national standards, and assist agencies with selection of independent peer reviewers from other state agencies
Provide central training sessions, professional development opportunities, and recognition programs for internal auditors
Administer a program for sharing internal auditors among state agencies needing temporary assistance and assembly of interagency teams of internal auditors to conduct internal audits beyond the capacity of a single agency
Maintain a central database of all annual internal audit plans, topics for review proposed by internal audit plans, internal audit reports issued, and individual findings and recommendations from those reports
Require reports in writing from any state agency relative to any internal audit matter
<p>If determined necessary by a majority vote of the council,</p> <ul style="list-style-type: none"> • conduct hearings relative to any attempts to interfere with, compromise, or intimidate an internal auditor • inquire as to the effectiveness of any internal audit unit • authorize the Chair to issue subpoenas for the appearance of any person or internal audit working papers, report drafts, and any other pertinent document or record regardless of physical form needed for the hearing
Issue an annual report including service efforts and accomplishments of state agency internal auditors and propose legislation for consideration by the Governor and General Assembly

Source: Program Evaluation Division based on N.C. Gen. Stat. § 143-747(c).

During Fiscal Year 2018–19, 36 North Carolina state agencies maintained a total of 187 internal audit positions.

The Department of Transportation performs its internal audit function by maintaining an Office of Inspector General (OIG) comprised of five units. DOT OIG is organized into the following work units:

1. Inspector General/Administrative Assistant: This category encompasses the managerial and administrative duties of the office.

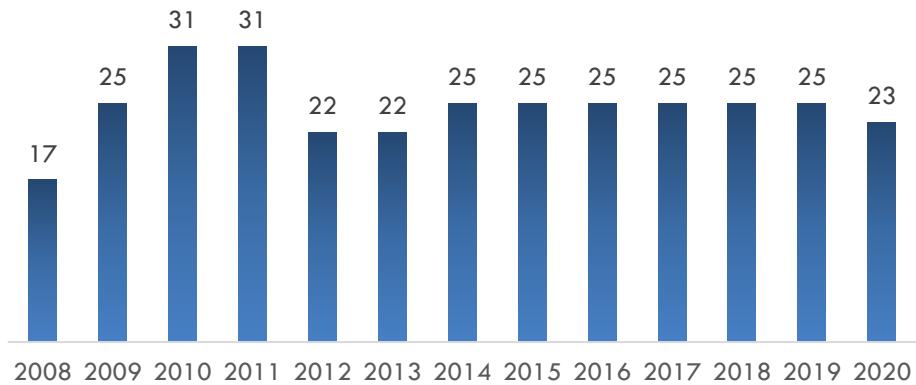
2. Internal Audit: This unit works on internal audits. The primary focus is on operational audits related to compliance with federal and state laws, regulations, and internal policies. The unit's emphasis is on efficiency and effectiveness of operations.
3. Consultant, Utility, Railroad and Turnpike (CURT): This unit primarily reviews professional services contracts between the department and consulting firms. It also reviews municipal, railroad, and utility contracts when a municipality engages a consultant. Items reviewed include pay rates, overhead rates, and other non-salary costs. Invoices to the department for these services are reviewed by this unit before they are forwarded to the Commercial Accounts unit for payment.
4. Single Audit Compliance Unit (SACU): This unit performs audits of grant and allocation programs for compliance with federal and state laws and regulations. Primarily, it focuses on federal and state compliance supplements. Audits of programs include reviews of subrecipients and compliance with grant agreements. This unit reviews audited financial statements submitted by local governments to the Local Government Commission, reviews for findings and potential impacts related to DOT funds, and reviews for determination of need for management decision letters.
5. Investigations: This category includes investigations related to the following:
 - fraud, waste, or abuse or related misconduct (complaints received via the fraud hotline, phone calls, mail, internal requests, or referrals from other agencies when related to DOT matters);
 - matters for which DOT OIG is requested to investigate; and
 - computer use for compliance with the agency's acceptable use policy.

DOT OIG has a \$2.7 million annual budget, almost all of which goes towards personnel costs. As shown in Exhibit 3, authorized positions within OIG decreased from 31 in 2011 to 23 as of February 2020, of which only 17 are filled.⁵ DOT supplements its OIG staff with temporary and contract staff.

⁵ In July 2020, NC Sess. Law 2020-91 eliminated the six vacant auditor positions at DOT OIG for Fiscal Year 2020–21.

Exhibit 3

DOT OIG
Authorized Full-time
Positions Have
Decreased by 26%
Since 2011



Note: In 2006, when the State Auditor reported on internal auditing activities at state agencies, the Department of Transportation had nine internal auditor positions.

Source: Program Evaluation Division based on annual activity reports prepared by the Council of Internal Auditing and data provided by the Department of Transportation's Office of Inspector General.

DOT OIG staff is large relative to most other state agencies. Compared to other state agency internal audit offices, only the Department of Health and Human Services maintains a larger internal audit staff with 38 positions.

Of the OIG's 15 internal auditors, 10 (67%) hold internationally recognized professional certifications. Eight of 15 (53%) have advanced degrees beyond a bachelor's degree.⁶ In compliance with the North Carolina Internal Auditing Act, DOT has appointed an Inspector General who directs OIG and is currently a Certified Public Accountant. As required by IIA's *International Standards for the Professional Practice of Internal Auditing*, DOT also maintains a current charter that has been reviewed and approved by the Chairman of the Board of Transportation and the Secretary of DOT.

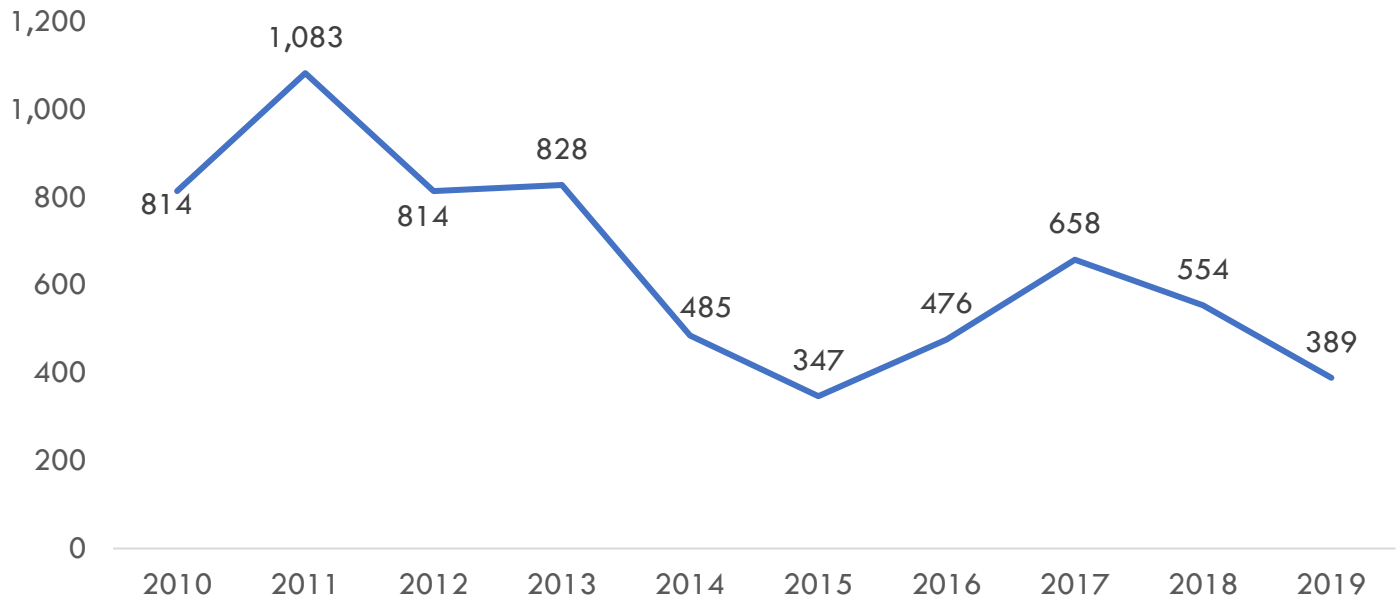
Oversight of the internal audit function at DOT is assigned to the following two organizations:

- the Board of Transportation's Audit Committee, which is a five-member committee that includes the Secretary of DOT; and
- the Council of Internal Auditing, whose authority and duties are listed in the State Internal Audit Act and codified in N.C. Gen. Stat. § 143-747.

DOT has reported a high number of internal audit engagements over the last 10 years, though production has declined. As Exhibit 4 demonstrates, though the total number of audit engagements performed by the department has fluctuated from year to year, DOT OIG consistently reports a high volume of audit engagements to the Council of Internal Auditing. Appendix C provides a detailed breakdown of the number of each type of internal audit performed by DOT OIG for every year from 2010 to 2019.

⁶ There are 17 filled positions in total with the inclusion of the Forensics Investigator and the Inspector General's administrative assistant.

Exhibit 4: DOT OIG Total Internal Audit Engagements Have Declined Since 2011 But Remain High Overall



Source: Program Evaluation Division based on annual activity reports prepared by the Council of Internal Auditing.

Findings

Finding 1. Due to internal oversight shortcomings, the Department of Transportation's Office of Inspector General failed to conduct the types of internal audits that could have flagged overspending and cash flow problems identified by a national consulting firm and the State Auditor.

As noted in the Background, the State Auditor's 2006 report highlighted internal audit deficiencies at many agencies and made specific reference to the Department of Transportation (DOT). Subsequently, the General Assembly passed the Internal Audit Act, raising expectations and standards for internal audit efforts statewide. The legislation provided for enhanced quality and uniformity of internal audit activities and processes within agencies.

DOT management consists of three top executive officers, including the Secretary, and eight executives reporting directly to the Secretary including the head of the Office of Inspector General (OIG). Management is responsible for ensuring that internal auditors focus on high-risk areas and internal control weaknesses and is further responsible for implementing corrective action recommended by internal auditors. Internal auditing can be rendered ineffective by a lack of independence, low production, political interference, or failure of management to act proactively when internal auditors provide quality work products.

Performance auditing is an imperative component of effective internal auditing. Performance audits evaluate the effectiveness and efficiency of operations. They are typically the signature products of an internal audit

office. Exhibit 5 shows how many of each type of internal audit report/engagement DOT OIG performed during the last three fiscal years. Appendix D presents a self-assessment of key elements of performance measurement submitted by DOT OIG.

Exhibit 5: DOT OIG Performed Zero Performance Audits During the Past Three Fiscal Years

Audit Type	2017	2018	2019
Compliance	556	468	277
Consulting Service	76	52	68
Investigative	23	32	42
Risk Assessment	1	1	1
Internal Controls Assessment	0	1	1
Follow-Up	2	0	0
Financial	0	0	0
Information Systems	0	0	0
Performance/Operational	0	0	0
Integrated	0	0	0
Total Engagements/Reports	658	554	389
Note: In 2019, the EAGLE (Enhancing Accountability in Government through Leadership and Education) Report was incorrectly classified as a performance/operational audit. The EAGLE Report is an internal control project, not a performance/operational project. Data was corrected in the chart above. More information about the EAGLE program can be found in Appendix A.			

Source: Program Evaluation Division based on annual activity reports prepared by the Council of Internal Auditing.

In the past three years, DOT has conducted zero performance audits and most review engagements concluded with no written report.

Instead, engagements often culminated in form letters, emails, or undocumented discussions. DOT OIG did not conduct any financial, follow-up, information systems, or integrated audits during Fiscal Year 2018–19.⁷ Further, DOT has not produced a performance audit since 2016.

The 1,601 audit engagements DOT delivered in total during the past three years included only two internal control assessments and three risk assessments. In contrast, DOT OIG reported 1,301 compliance engagements, which represents 81% of all engagements during the time period. The nature of those engagements warranted further scrutiny by the Program Evaluation Division, which is presented in Finding 2.

Consulting engagements are also within the scope of internal audit units established in accordance with the State Internal Audit Act. Auditors provided 1,500 hours of technical assistance to DOT management in Fiscal Year 2018–19. However, auditors did not issue a written report following each consulting engagement. Lack of documentation leaves management without the substantiated detail necessary to evaluate and hold

⁷ Integrated audits are audits that have a comprehensive scope. For example, a traditional audit may focus on financial or operational aspects, whereas an integrated audit will take a more global approach and look at several aspects including, but not limited to, financial, operational, IT, regulatory, compliance, environmental, and fraud controls.

accountable both the subjects of the consulting engagements and the internal auditors who conducted them.

Peer reviews in 2012 and 2018 flagged deficiencies at DOT OIG. Peer reviewers have examined DOT OIG twice since enactment of the Internal Audit Act of 2007. The purpose of these peer reviews was to evaluate and express an opinion on an internal audit function's compliance with the Institute of Internal Auditors's International Professional Practices Framework standards. DOT did not use the state Council of Internal Auditing's peer review program to review OIG but instead used the peer review activity provided by the American Association of State Highway Transportation Officials (AASHTO). AASHTO has expertise in internal auditing as well as experience with state and local government transportation operations nationwide.

AASHTO reviewers issued DOT a disclaimer in 2012 because the peer review team could not express an opinion on OIG's compliance due to 11 exceptions. Although DOT OIG passed its January 2018 AASHTO external peer review, the office was assigned a rating of "Pass with Deficiencies." The deficiencies included failure to have submitted to a peer review during the three previous years, using an outdated audit manual, and performing non-auditing services affecting auditor independence.

DOT management and the State Board of Transportation Audit Committee did not direct DOT OIG to conduct an internal performance audit of strategic funding and spending control problems.

Transportation infrastructure construction contracting and maintenance are expensive, involving billions in capital investment. OIG has maintained sufficient staff with education, experience, and professional credentials to perform performance audits according to standards. It was DOT management's responsibility to identify the risks inherent in management of spending and construction contracting and direct OIG to conduct at least one if not several performance audits encompassing these areas.

Critical reviews of DOT funding and spending identified a lack of controls as a root cause of issues that may have been flagged and corrected earlier had management required strategically focused performance audits.⁸ The Office of State Budget and Management contracted with the McKinsey & Company consulting firm in response to General Assembly and DOT concerns about the strain being placed on the department's cash reserves. In September 2019, DOT released McKinsey's financial review. McKinsey found that multiple factors contributed to DOT's cash variance, with one-third being directly attributable to natural disasters. However, the report also repeatedly cited a lack of controls to prevent variances as a root cause of the department's financial issues. State law requires that internal audit functions periodically examine agency controls. As described earlier, the vast majority of engagements that the DOT board and management assigned to its OIG consisted of compliance reviews of overhead rates prior to payment and other limited

⁸ In auditing, controls are defined as any actions taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved.

examinations that would not have identified these problems and were not performed according to standards.

A 2020 State Auditor performance audit found that DOT overspent \$742 million due to poor management and inadequate oversight of spending.⁹ The audit report further stated that increased oversight was needed. The following excerpt is from the State Auditor's report:

The Department of Transportation (Department) planned to spend approximately \$5.94 billion in state fiscal year 2019, but exceeded that amount by \$742 million (12.5%) and was in danger of falling below the statutory cash floor. The Department exceeded its Spending Plan because the (1) Spending Plan was not based on cost estimates of the specific projects and operations the Department scheduled for the fiscal year, (2) Chief Engineer's Office did not monitor highway division compliance with the Spending Plan, and (3) the Chief Engineer's Office did not enforce highway division compliance with the Spending Plan. (footnotes omitted)

DOT asserted in its response to the State Auditor that it conducts four types of internal audits (EAGLE internal control, CAFR, Single Audit, and Financial Statement), which demonstrated ongoing oversight over its spending plan and procedures. The State Auditor rebutted DOT's assertions, stating:

*"While the Department is subject to the audits listed, this response could mislead the reader to believe that these audits would or could have prevented or detected the issues identified in this audit report or provide the level of additional oversight for the Department's Highway Funds this audit report says should be considered. **They would not.** (emphasis supplied by State Auditor)... Each of the audits listed by the Department (EAGLE internal control self-reports, CAFR, Single Audit of Federal Funds, and Financial Statement) has certain objectives, by regulations or auditing standards, and their conclusions are limited to those objectives only. Further, audits occur "after the fact" and are never meant to replace management's responsibilities for on-going monitoring of agency budgets and spending."*

Despite the magnitude of capital investment involved and the fact that spending planning and construction contracting are core functions of the department, DOT failed to conduct any performance audits of closely related scope using methods required by standards in effect since 2008.

Finding 2. The majority of audits conducted by DOT internal audit staff are misaligned with best practices concerning functional boundaries and intra-organizational independence.

Internal staffing and work productivity levels suggest DOT demonstrates robust internal audit functionality, yet the majority of the scope of work performed by internal audit staff in the department fails to model best practices with regards to functional delineation and independence. As a result, audit engagements align more closely with management functions

⁹ Office of the State Auditor. (2020, May). *Department of Transportation, Cash Spending Plan*. Retrieved from <https://www.auditor.nc.gov/EPSSWeb/reports/performance/PER-2020-4200.pdf>.

than internal audit operations. As discussed in Finding 1, two external peer reviews observed that OIG work products were not conducted pursuant to standards.

Compliance audits performed by DOT’s internal auditors are most closely aligned with management duties, which violates the recommended scope and independence of the internal audit function. DOT OIG reported that the majority (71%) of its 389 audit engagements in Fiscal Year 2018–19 were compliance audits. DOT provided documentation for most audit engagements at the Program Evaluation Division’s request. However, letters to management indicated the department performed some engagements without issuing a corresponding report.

As shown in Exhibit 6, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has established standards and best practices for internal audit functions. COSO idealizes an organizational structure to execute risk mitigation and control duties using a “three lines of defense” model.¹⁰

Exhibit 6: COSO’s Three Lines of Defense Model Distinctly Separates Management and Internal Audit Functions

1st Line of Defense		2nd Line of Defense	3rd Line of Defense
Management Controls	Internal Control Measures	Financial Control	Internal Audit
		Security	
		Risk Management	
		Quality	
		Inspection	
		Compliance	

Source: Committee of Sponsoring Organizations of the Treadway Commission’s (COSO) *Leveraging COSO Across Three Lines of Defense by the Institute of Internal Auditors* (July 2015).

This model is intended to enhance understanding of risk management and control by clarifying roles and duties. Undergirding the model is the premise that, under the oversight and direction of senior management and the board of directors, three separate groups (or lines of defense) within an organization are necessary for effective risk management and control.

The scope and nature of the compliance engagements being performed by DOT are more consistent with second line functions as depicted in the COSO model. The COSO model explicitly states that the scope of internal audit work can encompass all aspects of an organization’s operations and activities but should not include the actual performance of management functions.

¹⁰ COSO develops comprehensive frameworks and guidance on enterprise risk management, internal control, and fraud deterrence designed to improve organizational performance and governance and reduce the extent of fraud within organizations.

The compliance audits reported by DOT appear to blur boundaries of internal audit independence and the engagements categorized by DOT OIG as compliance audit reports consist almost exclusively of contractor overhead/cost reviews.¹¹ Standard 1100 of the International Professional Practices Framework states that “Internal audit activity must be independent, and internal auditors must be objective in performing their work.” Independence is defined here as “the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.”

Such conditions can emerge from organizational placement and assigned internal audit responsibilities. When internal audit fulfills other functions within an organization that are themselves subject to audit, such as management functions, the internal audit unit is not considered to be working independently. An Institute of Internal Auditors practice advisory for internal audit’s responsibility for other (non-audit) functions states, “Internal auditors are not to accept responsibility for non-audit functions or duties that are subject to periodic internal audit assessments. If they have this responsibility, then they are not functioning as internal auditors.”¹²

The Program Evaluation Division concluded that the majority of engagements executed by DOT internal audit staff during the past three years are inconsistent with standards governing independence. It should be noted that DOT OIG did not assert that the engagements were performed in compliance with standards. Further, 97 of DOT OIG’s engagements during this time period can be categorized as investigations primarily of allegations concerning employee use of computers and other technology. These review engagements do not constitute internal auditing.

The Program Evaluation Division reviewed the last four DOT OIG annual audit plans and found 75 internal audit topics identified for potential projects. On average, the plan allocated 7,110 hours each year in the audit plan for internal auditing work. Exhibit 7 shows seven named internal audit active engagements that were started based on information in the last three OIG annual audit plans but have yielded no actual reports. As Exhibit 8 further shows, OIG has produced no performance/operational audits since 2016 and only seven performance/operational audits during the past decade.

¹¹ Appendix E provides an example of an approved overhead rate engagement report.

¹² Institute of Internal Auditors Practice Advisory 1130.A2-1: Internal Audit’s Responsibility for Other (Non-audit) Functions.

Exhibit 7: Seven Named Internal Audit Active Engagements from the Last Three DOT OIG Annual Audit Plans Have Yielded No Actual Reports

Fiscal Year	Description
2017	DMV Cash Handling (Cash Controls)
2017	Office of Civil Rights (Contract, Controls)
2017	Turnpike Authority (CSC Management)
Fiscal Year	Description
2018	DMV Cash Handling (Internal Controls)
2018	IT Security (Agency: Access Controls - Termination)
2018	DMV Assessment (Process Documentation)
Fiscal Year	Description
2019	DMV Motor Fleet (Process Controls: Assignment/Utilization/Maintenance)

Source: Program Evaluation Division based on DOT OIG annual audit plans from Fiscal Years 2016–17 through 2018–19.

Exhibit 8: DOT OIG Has Produced Only Seven Performance/Operational Audits Since 2010

Fiscal Year	Performance/Operational Audits	Investigative Audits	Compliance Audits	Total Audits	DOT Compliance Percentage	Statewide Compliance Percentage	Technical Assistance Hours
2010	0	49	723	814	89%	57%	Not reported
2011	1	90	960	1,083	89%	61%	Not reported
2012	0	37	740	814	91%	51%	Not reported
2013	4	0	808	828	98%	62%	Not reported
2014	0	0	480	485	99%	51%	0
2015	1	53	269	347	78%	35%	300
2016	1	25	384	476	81%	40%	500
2017	0	23	556	658	84%	41%	2,000
2018	0	32	468	554	84%	39%	2,000
2019	0	42	277	389	71%	34%	1,500
TOTALS	7				86%	47%	N/A

Note: Technical Assistance Hours are for time provided to management that did not result in the issuance of a report.

Source: Program Evaluation Division based on DOT OIG’s Annual Internal Audit Activity Reports.

Finding 3. The Council of Internal Auditing has been viable and active but has not probed or challenged the effectiveness of internal audit entities.

Since being established in 2008, the Council of Internal Auditing has met often and regularly, kept minutes, set standards and policies, established a recognition program, and reported annually on internal audit activities and recommendations for legislation affecting internal auditing.

Council staff consists of a Director and five auditors housed within the Governor’s Office of State Budget and Management. The Council has successfully accomplished the following tasks:

- provided standards and guides,
- established a repository of internal audit plans and reports,
- compiled statistics on characteristics and staffing of audit units,
- provided training to internal auditors, and
- coordinated pooled internal auditing and peer review services to agencies.

The Program Evaluation Division reviewed all of the Council's annual reports since 2008 for any narrative or statements specifically concerning the effectiveness of DOT's internal audit operation, as opposed to figures or descriptive data tabulated for internal audit operations across all state agencies. The annual reports contained six specific references to DOT during the 12-year period (2008-2019):

- one was a narration within a table stating that the American Association of State Highway Transportation Officials (AASHTO) performed DOT's peer review in 2012;
- four were related to "significant" changes in the number of internal audit employee positions at DOT; and
- one referenced an award given to the retired DOT Inspector General.

During this 12-year period, annual Council reports made no narrative references to the functionality of DOT's internal audit operations.

The Council has not exercised its authority to hold hearings on the effectiveness on any internal audit unit as authorized by N.C. Gen. Stat. § 143-747(c)(11). If the Council determines such a necessity by majority vote, it has the authority to

- conduct hearings relative to any attempts to interfere with, compromise, or intimidate an internal auditor;
- **inquire as to the effectiveness of any internal audit unit** (emphasis added by PED); and
- issue subpoenas for the appearance of any person or internal audit working papers, report drafts, and any other pertinent document or record regardless of physical form needed for the hearing.

In summary, the DOT OIG is ineffective due to inadequate oversight by DOT management and the State Board of Transportation Audit Committee. OIG conducts few performance, internal control, financial, or information systems audits according to standards. The majority of audits conducted by DOT internal auditors are misaligned with best practices prescribing functional boundaries and intra-organizational independence. The Council of Internal Auditing has been viable and active but has not probed or challenged the efficiency or effectiveness of internal audit entities. The Council could have identified the shortcomings of DOT OIG by validating the content of reports and data DOT submitted to the Council.

Recommendations

Recommendation 1. The General Assembly should direct the State Board of Transportation Audit Committee to revisit the Department of Transportation's Office of Inspector General's (DOT OIG) annual audit plan and determine why DOT OIG is not publishing reports.

The State Board of Transportation Audit Committee should begin including completed reports from DOT OIG's annual audit plan as a dashboard item at each monthly meeting of the Board of Transportation by October 1, 2020. The State Board of Transportation Audit Committee should report on implementation of this recommendation to the Joint Legislative Transportation Oversight Committee by October 1, 2021.

Recommendation 2. The General Assembly should direct the Council of Internal Auditing to conduct a hearing on DOT internal audit functions and assist DOT in improving the effectiveness of OIG.

The Council of Internal Auditing should receive testimony from DOT and independent experts and recommend corrective actions to DOT. The Council should report its recommendations to the Joint Legislative Transportation Oversight Committee by October 1, 2020.

After the hearing, the Council of Internal Auditing should work jointly with DOT on a general overhaul of OIG to improve its effectiveness and enhance its independence by ensuring OIG engagements do not blur boundaries of management activities. The Council should report to the Joint Legislative Transportation Oversight Committee on implementation of this portion of the recommendation by October 1, 2021.

Recommendation 3. The General Assembly should direct the Council of Internal Auditing to establish and monitor compliance with standards for all state agency internal audit units.

The Council of Internal Auditing should

- establish a minimum level of performance audit effort in compliance with standards for agency internal audit units;
- periodically examine a stratified sample of internal auditing reports and annual plans for conformity and report deficiencies; and
- review every external quality assurance review for each agency internal audit function, hold hearings on any reported deficiencies, and monitor corrective action.

If the Council approves a resolution defining requirements, the General Assembly should consider providing funding for the Council to contract with experts to perform more complex reviews of audit units and provide expertise on internal auditing operations, standards, and technology.

The Council of Internal Auditing should report to the Joint Legislative Oversight Committee on General Government on the status of this recommendation by June 1, 2021.

Appendices

Appendix A: Glossary of Accounting and Auditing Terms

Appendix B: Department of Transportation's Official Response to the 2006 State Audit on Internal Auditing in North Carolina Agencies and Institutions

Appendix C: DOT Office of Inspector General Total Reports by Engagement Type for Fiscal Years 2010–2019

Appendix D: DOT OIG Self-Assessment of Key Elements of Performance Measurement

Appendix E: Example of Approved Overhead Rate Engagement Report

Agency Response

A draft of this report was submitted to the Department of Transportation, Council of Internal Auditing, and Office of the State Auditor to review. Their responses are provided following the appendices.

Program Evaluation Division Contact and Acknowledgments

For more information on this report, please contact the lead evaluator, Jim Horne, at jim.horne@ncleg.gov.

Staff who made key contributions to this report include Sean Hamel and Josh Love. John W. Turcotte is the director of the Program Evaluation Division.

Appendix A: Glossary of Accounting and Auditing Terms

Assurance Services

An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

Compliance Audits

This category includes any compliance-related audits. It also includes overhead and pre-award reviews.

Compliance audits determine adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

Consulting Services

Advisory and related client service activities, the nature and scope of which are agreed upon with the client and are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.

Control

Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management is responsible for planning, organizing, and directing the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

Control Environment

The attitude and actions of the board and management regarding the importance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:

- integrity and ethical values,
- management's philosophy and operating style,
- organizational structure,
- assignment of authority and responsibility,
- human resource policies and practices, and
- competence of personnel.

Control Processes

The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept.

Governance

The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

Integrated Audits

This category includes the annual testing of financial, compliance, information technology, and end-user computing controls.

Internal Control Reviews (EAGLE Program)

In 2008, the Office of the State Controller began a phased-in implementation of a statewide internal control program called EAGLE (Enhancing Accountability in Government through Leadership and Education). The EAGLE program resulted from the passage of Session Law 2007-520 (State Governmental Accountability and Internal Control Act) during the 2007 Session of the General Assembly.

The purpose of the EAGLE program is not only to establish adequate internal control but also to increase fiscal accountability within state government. Under the EAGLE program, each agency is required to perform an annual assessment of internal control over financial reporting and compliance. By performing this assessment, agencies can identify risks and compensating controls that reduce the possibility of material misstatements, misappropriation of assets, and noncompliance with governmental rules and regulations.

The assessment also assists agencies in recognizing opportunities to increase efficiency and effectiveness in business processes and operations.

Investigative Audits

This category includes investigations related to the following:

- fraud, waste, or abuse or related misconduct (complaints received via the fraud hotline, phone calls, mail, internal requests, or referrals from other agencies when related to DOT matters);
- matters for which OIG is requested to investigate; and
- computer use for compliance with the agency's acceptable use policy.

Performance Audits

This category includes audits conducted to assess efficiency and effectiveness in operational areas.

Risk Assessments

This category includes assessments completed to develop the annual audit plan.

Risk Management

A process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.

Special Project

The Office of Inspector General (OIG) serves as DOT custodian over employees' email accounts and serves as a control over access to email accounts. OIG, using eDiscovery, performs email searches and provides those records to/for the following:

- DOT Communications office – in response to public records requests for email communications;
- DOT General Counsel – in response to legal matters/litigation;
- NCDOJ – in response to legal matters/litigation;
- Internal management – for justifiable and approved business purposes; and
- OIG – for investigations purposes.

Source: Program Evaluation Division based on definitions from the Institute of Internal Auditors's International Professional Practices Framework and from information provided by DOT OIG.

Appendix B: Department of Transportation's Official Response to the 2006 State Audit on Internal Auditing in North Carolina Agencies and Institutions

STATE OF NORTH CAROLINA DEPARTMENT OF TRANSPORTATION

MICHAEL F. EASLEY
GOVERNOR

1501 MAIL SERVICE CENTER, RALEIGH, N.C. 27699-1501

LYNDO TIPPETT
SECRETARY

October 6, 2006

Mr. Leslie W. Merritt, Jr., CPA, CFP
State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Auditor Merritt:

Thank you for the effort and resources that your office has devoted to internal auditing within the Department of Transportation and across state agencies. Internal auditing should perform a vital role in the Department's ability to manage its resources, risks and accountability. I am also very aware of the urgent need for effective internal auditing if government agencies wish to avoid significant financial losses, as well as the loss of public confidence and trust that have recently occurred in the private sector.

The report has findings and recommendations that are generic to all internal audit sections as well as recommendations specific to the Department. I have carefully reviewed each recommendation, and the Department's response is in the following paragraphs:

1. North Carolina State Government and Its Institutions Lack Sufficient Internal Audit Policies

Recommendation: The General Assembly should enact legislation clearly defining the internal audit expectations for each agency. Internal audit functions should be established in accordance with generally accepted internal audit principles and best practices.

Response: The Department endorses legislation that would set a statewide minimum standard for the operation of an internal audit function.

2. No finding or recommendation
3. Internal Audit Organizations Are Not Obtaining Quality Assurance Reviews by Outside Parties

Recommendation: Internal audit organizations should obtain as part of their quality assurance program an external quality assessment review at regular intervals.

PHONE 919-733-2520 FAX 919-733-9150

Mr. Leslie W. Merritt, Jr., CPA, CFP
October 6, 2006
Page 2

Response: The Department will ensure that the Internal Audit Section obtain an external quality assessment review once every three years in accordance with the Government Auditing Standards under which it operates.

4. Some Internal Audit Sections Did Not Report To the Highest Management Level Within the Organization

Recommendation: The state entities noted in table 1 should revise their internal audit reporting structures so that the internal audit function reports to the highest level within the organization.

Response: The Department will alter the reporting by its Internal Audit Section and will also incorporate reporting to the Board of Transportation's Audit and Contract Committee.

5. Some Internal Audit Organizations Did not Execute an Annual Audit Plan While Others did Not Perform Risk Assessments to Develop an Audit Plan

Recommendation: All internal audit organizations should comply with internal auditing standards by establishing an annual audit plan based on an effective risk assessment.

Response: The Department will ensure that the Internal Audit Section's annual audit plan is based upon appropriate risk assessment measures.

6. No finding or recommendation
7. No finding or recommendation
8. Some Internal Audit Sections Lacked Adequate Policies and Procedures

Recommendation: No recommendation specific to the Department.

Response: Item #10 in the Report mentions that the Internal Audit Section has not complied with the latest peer review recommendations on policy and procedure issues. This will be immediately addressed.

9. No finding or recommendation
10. The Department of Transportation Internal Audit Section Has Experienced Significant Difficulties With Completing Audits and Producing Audit Reports

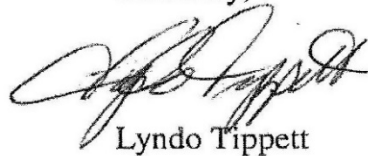
Mr. Leslie W. Merritt, Jr., CPA, CFP
October 6, 2006
Page 3

Recommendation: To achieve organizational independence and ensure proper oversight of operations, the Chief Internal Auditor should report directly to the Secretary, Chief Deputy Secretary, or to the audit committee of the Board of Transportation. The Secretary of Transportation should take steps to improve the performance of the Internal Audit Section that could include organizational and functional restructuring.

Response: Per recommendation #4, the reporting will be adjusted and expanded. Furthermore, an immediate review of the organization and functional structure will be conducted to ascertain that proper management oversight is exercised to increase productivity and performance.

I appreciate the opportunity to comment on the findings and recommendations contained in the "Performance Audit of Internal Auditing in North Carolina Agencies and Institutions." I also am grateful for the objectiveness and thoroughness of the audit team from the Office of the State Auditor. Their information gathering was comprehensive and has defined numerous opportunities for the Department and the state to strengthen internal auditing functions.

Sincerely,



Lyndo Tippett

LT:bd

cc: Daniel H. DeVane, Chief Deputy Secretary
Willie Riddick, Deputy Secretary of Administration and Business Development
Herb Henderson, Human Resources Director
Mark Foster, Chief Financial Officer

Source: North Carolina Office of the State Auditor *Internal Auditing in North Carolina Agencies and Institutions*, September 2006.

Appendix C: DOT Office of Inspector General Total Reports by Type of Engagement for Fiscal Years 2010–2019

Fiscal Year	Financial	Performance	Investigative	Compliance	Internal Controls Assessment	Information Systems	Risk Assessment	Follow-Up	Special Review Projects	Consulting Service	Integrated	Total
2010	2	0	49	723	35	1	0	3	1	0	0	814
2011	32	1	90	960	0	0	0	0	0	0	0	1,083
2012	33	0	37	740	1	0	0	0	3	0	0	814
2013	6	4	0	808	0	0	0	0	10	0	0	828
2014	0	0	0	480	0	0	0	0	5	0	0	485
2015	0	1	53	269	0	0	0	0	24	0	0	347
2016	0	1	25	384	0	0	1	0	65	0	0	476
2017	0	0	23	556	0	0	1	2	0	76	0	658
2018	0	0	32	468	1	0	1	0	0	52	0	554
2019	0	0	42	277	1	0	1	0	0	68	0	389

Note: In 2019, the EAGLE Report was incorrectly classified as a performance/operational audit. The EAGLE Report is an internal control project, not a performance/operational project. Data was corrected in the chart above.

Source: Program Evaluation Division based on annual activity reports prepared by the Council of Internal Auditing.

Appendix D: DOT OIG Self-Assessment of Key Elements of Performance Measurement

Key Elements of Performance Measurement	Key Element Ratings		
	Meets	Partially Meets	Does Not Meet
Performance measures assess key inputs.	X		
Performance measures assess key outputs.	X		
Performance measures assess efficiency/process.		X	
Performance measures assess quality.		X	
Performance measures assess key outcomes.		X	
Program has a defined method for collecting performance data.	X		
Program has a standard format for reporting performance data.	X		
Program validates performance measures periodically.	X		
Performance measures are regularly reported to managers, staff, and key stakeholders.		X	
Performance measures provide the level and type of data needed to conduct a rigorous evaluation of program impacts.		X	
	Overall Indicator Rating		
	Meets	Partially Meets	Does Not Meet
Program has performance measures.		X	

Note: Overall assessment of *Partially Meets* as the Department of Transportation has performance measures in place yet there are areas of improvement to capture additional performance measures beyond what the department currently collects. The Office of Inspector General has made progress in tracking performance measures for the four operational units—Internal Audit; Single Audit Compliance; Consultant, Utility, Rail and Turnpike; and Investigations.

Source: Program Evaluation Division based on responses by the NCDOT Office of Inspector General.

Appendix E: Example of Approved Overhead Rate Engagement Report



STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

ROY COOPER
GOVERNOR

JAMES H. TROGDON, III
SECRETARY

May 29, 2018

Mr. Shawn Wilkerson
President
Wildlands Engineering, Inc.
1430 S. Mint Street, Suite 104
Charlotte NC 28203

RE: Approved Overhead Rate and Certification of Costs for FYE 12/31/16

Dear Mr. Wilkerson:

North Carolina DOT has reviewed the FYE 12/31/16 Indirect Cost Schedule as performed by you and Certification of Final Indirect Costs.

The following rates are approved for FYE 12/31/16:

Home Rate [REDACTED] **Facilities Capital Cost of Money** [REDACTED]

North Carolina DOT approved these rates after performing a Risk Assessment.

Acceptance of your overhead rates does not constitute “establishment of a rate by a cognizant agency” for the purposes of applying the rules published in Title 23, CFR §172.7. NCDOT retains the right to audit the above rates or adjust them should a cognizant approval occur after this date. This approval letter was prepared for, and is intended for the use of NCDOT and its subrecipients. This letter will be provided to other governmental entities upon request, in accordance with 23 U.S.C. §112(b)(2)(E).

As a reminder, audit reports or indirect cost schedules must be certified and submitted annually within 180 days of the end of the firm’s fiscal year.

If you have any questions or need additional information, please do not hesitate to contact me at 919-707-4582 or by e-mail at lwraynor@ncdot.gov.

Sincerely,

Lonnetta Raynor, Manager
Consultant, Utility, Rail and Turnpike

Mailing Address:
NC DEPARTMENT OF TRANSPORTATION
OFFICE OF INSPECTOR GENERAL – C.U.R.T
1507 MAIL SERVICE CENTER
RALEIGH, NC 27699-1507

Telephone: (919) 707-4581
Fax: (919) 715-2710
Customer Service: 1-877-368-4968

Location:
1 SOUTH WILMINGTON STREET
RALEIGH, NC 27601

Website: www.ncdot.gov

Source: Program Evaluation Division based on information provided by the DOT Office of Inspector General.



STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

ROY COOPER
GOVERNOR

J. ERIC BOYETTE
SECRETARY

July 13, 2020

John W. Turcotte, Director
Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, North Carolina 27603-5925

Subject: Agency Response to Report 2020-08, Department of Transportation and Council of Internal Auditing Compliance

Mr. Turcotte:

Thank you for the work of you and your team on the report regarding the evaluation of the efficiency and effectiveness of the internal auditing program of the Department of Transportation and oversight of the program by the Department and by the North Carolina Council of Internal Auditing. The North Carolina Department of Transportation (NCDOT) appreciates the opportunity to respond to Report 2020-08.

This review highlights some of the challenges facing the Office of Inspector General (OIG) within NCDOT.

The first challenge is that tasks assigned to the OIG are broader than internal auditing and that much of the existing staff are utilized for critical functions that are not "audits". These tasks are compliance-related, those that detect fraud and identify misuse and those that involve investigating claims of mismanagement, fraud or abuse or providing information to the public. These functions are critical. These tasks have required the greatest investment of staff time. Other activities, known internally as engagements, have played a significant role in identifying and alerting management and business units to processes that need to be corrected to prevent misuse or fraud.

While we agree the internal audit function within NCDOT must be strengthened, the plan of work and subsequent efforts to achieve that plan of work should be formally evaluated by the Board of Transportation and the unit should adhere to the highest standards of work, we express concern with the ability to achieve all critical functions of an internal audit department with the resources currently available.

For example, evaluation of compliance which is a critical compliance and fraud-prevention related function, requires over 50% of our existing staff's time. In addition, the OIG office experienced a reduction in positions this year. The OIG acknowledges this business unit could and should be strengthened. To accomplish this OIG will work with NCDOT leadership to develop an improvement plan, a FY21 plan of work and an external reporting function. An improvement plan will be provided in draft to the Board of Transportation Audit Committee at the September committee meeting for review, discussion and subsequent implementation.

NCDOT will work with the Office of the State Auditor's staff as they conduct annual performance audits each year moving forward per HB77.

Respectfully,



Mary Morton, CPA
Office of Inspector General



STATE OF NORTH CAROLINA

COUNCIL OF INTERNAL AUDITING

Dr. Linda Combs
State Controller, Chair

Charles Perusse
State Budget Officer

Machelle Sanders
Secretary of Administration

Josh Stein
Attorney General

Ron Penny
Secretary of Revenue

Beth A. Wood
State Auditor

July 13, 2020

John Turcotte, Director
Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925

Dear Mr. Turcotte:

Thank you for the opportunity to comment on the Program Evaluation Division's confidential preliminary draft of Report No. 2020-08 – DOT Internal Audit. The Council of Internal Auditing (Council) has reviewed your report and would like to offer the following comments.

Since its creation by the General Assembly in 2007, the Council has been committed to fulfilling the prescribed responsibilities outlined in NCGS §143-747 and dedicated to supporting the internal audit functions throughout the State.

Consistent with those statutory responsibilities prescribed and defined by the General Assembly, I will highlight just a few of the Council's accomplishments:

- Established guidelines to ensure the uniformity and quality of State agency internal audit activities (accomplished through the adoption of The Institute of Internal Auditors Professional Practices Framework)
- Sponsored many training events to help improve internal auditor skills and competencies
- Supported numerous peer reviews to ensure internal audit functions are conforming with internal auditing standards and have required entities that fail to adhere to the standards to appear before the Council and provide a corrective action plan to address cited issues
- Established a State term contract to supplement the internal audit function to address staffing needs or skill deficiencies
- Established a central repository for all audit plans and audit reports
- Advocated for amendments to the Internal Audit Act to ensure that the internal auditing functions within the State remain resilient – building on an established and strong foundation set by the General Assembly

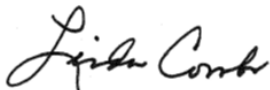
In your confidential preliminary draft report, you cited several recommendations for the Council to address with regard to the issues resulting from DOT internal audit function. While we find these issues to be very concerning, we believe that DOT executive management and the Audit Committee of the NCDOT Board have primary responsibility for overseeing resolution. As a Council, we stand ready to offer advice, support, and expertise as DOT leadership seeks to structure their corrective action plans.

It is the role of management to evaluate the effectiveness of internal auditors. The Council is not staffed for such an effort nor do we think that it should be the role of the Council. Per The Institute of Internal Auditors' definition of internal auditing..."internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." We do not believe the Council is positioned to determine if an internal audit function adds value or improves an organization's operations; nor is the Council positioned to determine if internal audit helps an organization accomplish its objectives. These are management roles.

The Council does, however, agree that there is a need for DOT Internal Audit and DOT Executive Management to appear before the Council to address the issues and to provide periodic updates regarding their corrective action plan. The Council will continue to monitor the progress of the DOT's corrective action plan until completed.

Together, we both share a common goal – to ensure the integrity, objectivity, and professionalism of the State's internal audit community. We have made many gains towards achieving this goal since the General Assembly's enactment of the Internal Audit Act nearly 13 year ago. With the General Assembly's support, we will continue moving in a positive direction. Again, please know that we appreciate the opportunity to provide our comments regarding the audit of the DOT Internal Audit function.

Sincerely,

A handwritten signature in black ink that reads "Linda Combs". The signature is written in a cursive, flowing style.

Linda Combs



BETH A. WOOD, CPA
STATE AUDITOR

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0600
Telephone: (919) 807-7500
Fax: (919) 807-7600

July 31, 2020

John Turcotte, Director
Program Evaluation Division
300 N. Salisbury Street, Suite 100
Raleigh, NC 27603-5925

Dear Mr. Turcotte:

Thank you for the opportunity to comment on the Program Evaluation Division's (PED) Report No. 2020-08-DOT Internal Audit. As the State Auditor of North Carolina serving also as a member (nonvoting member) of the Council of Internal Auditing (Council) I have reviewed your report and would like to offer the following comments.

First, I want to state that, while I am a member of the Council, I wish to offer a different perspective on the findings and recommendations of the PED report than those offered in the response from the full Council.

I agree with the Council's response that the Council has met many of the statutory responsibilities prescribed by the General Assembly in the Internal Audit Act of 2007 (the Internal Audit Act). I also agree that it is the responsibility of any Agency's/Organization's management to ensure that it has an effective, competent internal audit function in place to ensure that Agencies/Organizations meet the objectives of that Agency/Organization.

However, given most Agency Head's lack of proficiencies in the field of internal audit, the ability to assess the effectiveness and weaknesses in internal audit units would be better done by an outside, independent, objective body, like the Council.

Therefore, I concur with PED's Recommendation 3. **"The General Assembly should direct the Council of Internal Auditing to establish and monitor compliance with standards for all state agency internal audit units."**

The Council was established, by statute, to be an oversight body to ensure the Internal Audit Act was implemented consistently across all state agency internal audit units and in accordance with standards.

The Council has not been effective in this oversight role. The Council could and can do more to ensure consistent compliance with the Internal Audit Act to ensure findings like those with DOT's overspending of its spend plan and depleting its cash balance below that of statutory requirements, would be found sooner, so appropriate action can be taken by management before issues escalate.



The Council's effectiveness, as the oversight body of the State's internal audit function could be improved.

- Currently, the Council "collects" annual audit plans from agency internal audit units, **but there is no assessment** of the plan to ensure the plan was produced from a risk-based assessment as defined by standards prescribed in the Internal Audit Act.
- Currently the Council "collects" annual audit plans from agency internal audit units and reports to the General Assembly whether or not any were submitted within the required deadline; however, the General Assembly **is never made aware** of the progress of internal audit units' **actual** performance/delivery against their submitted plans.
- Currently, the Council "collects" the number of resources (in man-hours) spent on "supposed" internal audits and reports this information to the General Assembly **without any assessment** that the hours spent are commiserate with the work done and results published.
- Currently, the Council receives and reports to the General Assembly the number of "supposed" internal audits/audit reports performed/published by agency internal audit units **without any verification** that the audit performed and the reports issued were done so in compliance with audit standards prescribed in the Internal Audit Act.

Additionally, while I cannot speak to the effectiveness of the Peer Review program for internal audit units, the Quality Assurance Review required by the Council for all internal audit units is only conducted every 5 years. This makes the continued, more scrutinizing oversight of the Council more critical to ensure a successful statewide internal audit function.

Also, I wish to highlight that the State currently has 187 internal auditors, at a cost to the state of approximately \$17.8M. Ensuring that these resources are accomplishing the objectives of the Internal Audit Act is critical to North Carolina State Government. So again, I concur with PED's Recommendation 3. **"The General Assembly should direct the Council of Internal Auditing to establish and monitor compliance with standards for all state agency internal audit units."**

Thank you for allowing me to comment on PED's examination of the internal audit function at the Department of Transportation.

Sincerely,



Beth A. Wood, CPA