

**North Carolina Office of the State Auditor**  
Pervasive Findings  
Program Evaluation Oversight Committee  
September 12, 2016

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The Office of the State Auditor has identified several findings, that are the results of audits performed by the Office, that we consider to be pervasive, ( they cut across departments, agencies and administrations) and are impactful and unresolved.

Each time an audit is performed and issues that need to be corrected are identified, OSA has offered high-level recommendations to help guide the agencies/organizations to a resolution, but the specific solutions are the responsibility of management. Since OSA has no authority to enforce recommendations; if agency management chooses not to correct the issues they remain unresolved.

OSA performs several different types of audits, i.e., Financial Statement Audits, Audits of Federal Grants, Performance Audits, and Information Technology Audits. With each type of audit a different objective is achieved.

Below are described four categories of findings that we feel are the most pervasive and at the same time have a significant impact across state government. They are:

- **Management Oversight of Programs/Processes**
- **Contract Administration and Oversight**
- **Information Technology Project Implementation**
- **Information Technology Security**

**Management Oversight of Programs/Processes**

Management's responsibility is to put policies and procedures in place and to measure/monitor those policies and procedures to ensure that an organization's goals and objectives are met. Audits performed in several agencies reveal that management oversight over processes/programs/departments was deficient, resulting in the wasteful spending or objectives not being met. Some examples are:

An audit at the Division of Blind Services at the Department of Health and Human Services revealed that the state had spent \$29 million, since 2000, without any plan or metrics to help judge whether the program met the vocational needs of the blind. Additionally, the oversight activities (such as sanitation inspections, record keeping inspections, compliance monitoring and financial analysis) were not performed in accordance with agency policy nor were the required number performed.

The State Health Plan did not increase the outpatient discount rate as allowed in their contract with Baptist Hospital because no one was responsible for monitoring the terms of the contract, i.e., when the hospital increased its outpatient fees the contract allowed the state to negotiate an increase in the outpatient discount rate, which would reduce the cost for outpatient services to state employees/retirees. The overpayment to Baptist Hospital was estimated to be \$1.34 million.

The Department of Transportation did not review approximately \$179 million in open (unresolved) lapsed automobile liability insurance records to identify the amount owed to the state. The Department lacked policies and procedures to do so nor had they assigned anyone to the task. Additionally, due to the lack of oversight, \$7.3 million in penalties have had no real effort to collect.

See a listing of other audits relating to deficiencies in Management Oversight of Programs/Process in Attachment.

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**Contract Administration and Oversight**

The state awards billions of dollars a year to private vendors and nonprofits through contracts. An exact number cannot be easily reached because the state does not have a complete contract database and those it does have are not updated as required. However, a recent OSA audit found that DHHS alone awarded \$7.4 billion in contracts, excluding personal services contracts, between 2012 and 2014. Current State contracting practices put that money at risk.

According to PED and NCAS, the state spends approximately \$3.7 Billion in contracted goods and services a year but the figure does not include Medicaid contract expenditures.

Since 2008, OSA has published at least 14 audits detailing deficiencies in the way North Carolina contracting practices. Problems exist in every phase, including bidding, negotiation, administration and monitoring.

Bidding rules help ensure the state gets the best prices. The competition also leads to better service. Sidestepping bidding puts the state at risk of overpaying for services. Of DHHS' \$7.4 billion in contracts between 2012 and 2014, 2,500 contracts with a value of \$2.4 billion were not competitively bid.

OSA examined a sample of 59 no-bid contracts at DHHS. The audit found:

- Many lacked required review or approval by either the Attorney General's Office, the Division of Purchase and Contract, the Office of Information Technology Services. Some lacked multiple reviews.
  - 45 of the 59 contracts should have been negotiated, but only 12 had evidence of the required negotiation.
  - Of the 59 no-bid contracts selected for review, 27 (46%) with a value of about \$25.5 million, lacked adequate written justification
- Lack of negotiation leads to terms, schedules and other conditions that are less favorable to the state. The DHHS audit that examined no-bid contracts looked at a sample of 59 contracts that had not been competitively bid. Statutes require that when a contract meets the waiver criteria to be competitively bid, efforts to negotiate the best price should be made and those efforts are required to be documented. 45 should have been negotiated, but only 33 had evidence of negotiation. The value of the noncompliant contracts was \$43.6 million.

Contract Development and Review - Contracts need to include the scope of work, terms, conditions and process for oversight to ensure agencies have the tools they need to hold the vendors accountable and get the services they pay for. Too often, agencies pay for subpar work because contracts are simply poorly written.

For example, the pricing and timeline with CSC to build a new Medicaid claims processing system for DHHS was based on the vendor using 72% of the programming they had used to build a system for New York. This was a point of discussion but the 72% never showed up in the contract. The vendor later discovered that North Carolina was a multipayer state and could only use 34% of the programming used for New York thus driving up the cost and extending the time to build the system.

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When building the NC Tracks, the Center of Medicare and Medicaid (CMS) required all states to hire an independent third party to perform, as part of their tasks, independent verification and validation of the system's p. The DHHS hired a vendor but the vendor did not perform independent testing. They relied on the test results of the DHHS and the vendor who built the system. The main reason independent test case analysis of user and production testing did not occur was because the technical duties outlined in the contract did not enforce the independent monitoring and auditing of test activities.

One IT vendor who contracted with the State Board of Elections walked away with \$1 million without delivering any product or service because the contract did not allow the state to require performance or withhold payment.

- Poor administration, including lack of monitoring, allows the vendor to ignore the terms of the contract without penalty.

## **Information Technology**

### **Project implementation**

Project implementation remains a challenge for the state's information technology professionals. An OSA audit published in 2013 looked at 84 projects and found that on average they cost more than twice what the agency projected and ran more than a year behind schedule. Just this subset of projects ran \$356 million over budget. Part of the challenge has been that the relationship between state agencies and the Department of Information Technology remains unclear, although recent changes in the law may help give DIT better oversight. In the past, however, they have had weak to no oversight and projects do not receive strong review.

The NCTracks project lasted years longer than planned, cost the state nearly \$500 million and for much of its life had extremely poor direct management.

The Core Banking system in the State Treasurer's office was a \$5 million system, but responsible for \$20 billion in payments. OSA found that the project did not receive proper oversight from independent reviewers and struggled to test the system before it went live. Fortunately, OSA identified these issues before implementation and the project went live successfully.

Successful implementation did not happen with the Department of Revenue's TIMS system and the state was forced to scrap the system after investing five years and \$85 million.

### **Security**

A recent audit of Executive Branch IT management found they do not have good processes to prevent, detect, or respond to security threats. The cost of poor security is difficult to quantify, but the threat to personal and financial information stored in state computers is real and the cost of a breach could be significant as others have found. OSA has also conducted several audits of state agencies and universities and found specific security weaknesses. State law does not allow the public sharing of the most egregious of these findings, but again they exist and must be addressed.

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**State/Federal Grants**

The state grants millions of state appropriated dollars to nonprofits and other agencies that conduct business on behalf of the state. North Carolina also manages billions of dollars in federal money that passes through the state to municipalities, nonprofits and other groups charged with carrying out federal programs.

OSA has found that often the state does a poor job of ensuring that the state dollars that it gives out or the federal money that passes through the state to other agencies/nonprofits is monitored to ensure the money is spent in accordance with the state or federal government's intent.

An audit of the Department of Commerce identified \$80 million in grants that were not sufficiently monitored after being disbursed for the FY 2012. One of the recipients at the time, the North Carolina Rural Economic Development Center received nearly \$60 million and disbursed it to local governments to help promote economic development in their area. The audit found that the Rural Center did not monitor the disbursed funds to ensure the monies were spent in accordance with the agreements between the Rural Center and the local governments or nonprofits. Additionally, the Department of Commerce did not monitor the Rural Center to ensure that the moneys spent were monitored to ensure compliance with the intent of the use of the moneys.

Over the past four years, North Carolina has received a total of nearly \$87 billion from the federal government. Almost \$13.8 billion of that is then passed to subrecipients. Failing to monitor that money accounts for the largest number of findings reported to the federal government in the state's annual federal compliance audit. About 30 percent of our 369 findings in the past four years have been for poor monitoring of this enormous amount of money.

Also, the annual federal compliance audit continues each year to find programs spending federal money granted to the state in ways that are not allowed by the state's agreement with the federal government. The most recent Audit report estimated, through rigorous statistical sampling, that the state overpaid \$845 million in Medicaid claims in 2015.

Eligibility errors also continue to be a concern. OSA will publish an audit in December at the legislature's request examining Medicaid eligibility issues in detail. Currently the work is being performed by CPAs at the county level.