

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

A presentation to the
Joint Legislative Program Evaluation Oversight Committee

August 10, 2020

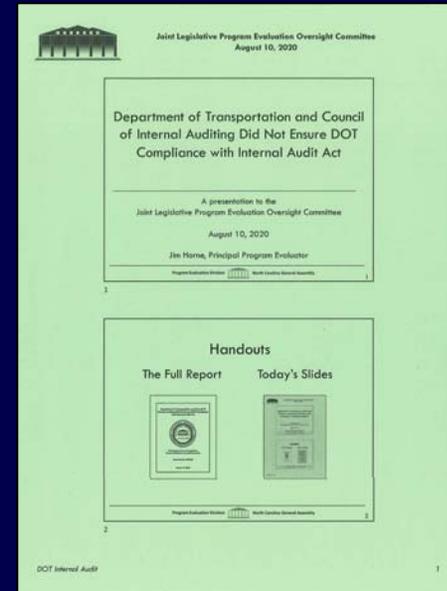
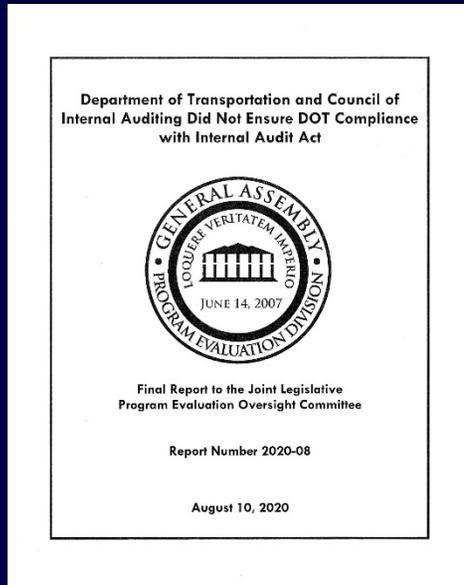
Jim Horne, Principal Program Evaluator



Handouts

The Full Report

Today's Slides



Our Charge

The JLPEOC 2019–20 Work Plan directed PED to examine the efficiency and effectiveness of DOT's internal audit program and oversight of the program by DOT and by the Council of Internal Auditing

Team included Director John Turcotte, Sean Hamel, and Josh Love

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Overview: Three Findings

1. DOT OIG failed to conduct types of internal audits that could have flagged overspending and cash flow problems identified by a national firm and the State Auditor
2. Majority of audits are misaligned with best practices concerning functional boundaries and independence
3. Council of Internal Auditing has been viable and active but has not probed or challenged the effectiveness of internal audit units



Overview: Three Recommendations

The General Assembly should direct the

1. State Board of Transportation Audit Committee to revisit DOT OIG's annual plan and determine why OIG is not publishing reports
2. Council of Internal Auditing to conduct a hearing on DOT internal audit functions and assist DOT in improving the effectiveness of OIG
3. Council of Internal Auditing to establish and monitor compliance with standards for all internal audit units within state agencies



Background



What Is Internal Auditing?

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations

— Institute of Internal Auditors

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State Auditor Reported in 2006 that Internal Auditing Was Deficient at State Agencies

- Many internal auditors were unqualified
- Auditors were not performing genuine internal audit work

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Internal Audit Act of 2007

Requires establishment of an internal audit unit within any state agency that has

- an annual operating budget exceeding \$10 million and more than 100 full-time employees, or
- receives and processes more than \$10 million in cash in a fiscal year

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Internal Audit Act of 2007 (Cont'd.)

Council of Internal Auditing created within OSBM

Council members serve *ex officio*

- State Controller (Chair)
- State Budget Officer
- Secretary of Administration
- Attorney General
- Secretary of Revenue, and
- State Auditor (as a non-voting member)

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Council of Internal Auditing Duties

- Provide standards and guides,
- Maintain repository of plans and reports,
- Compile statistics on staffing of audit units,
- Provide training to internal auditors,
- Administer independent peer review system, and
- Hold hearings on attempted interference with auditors and effectiveness of internal audit units

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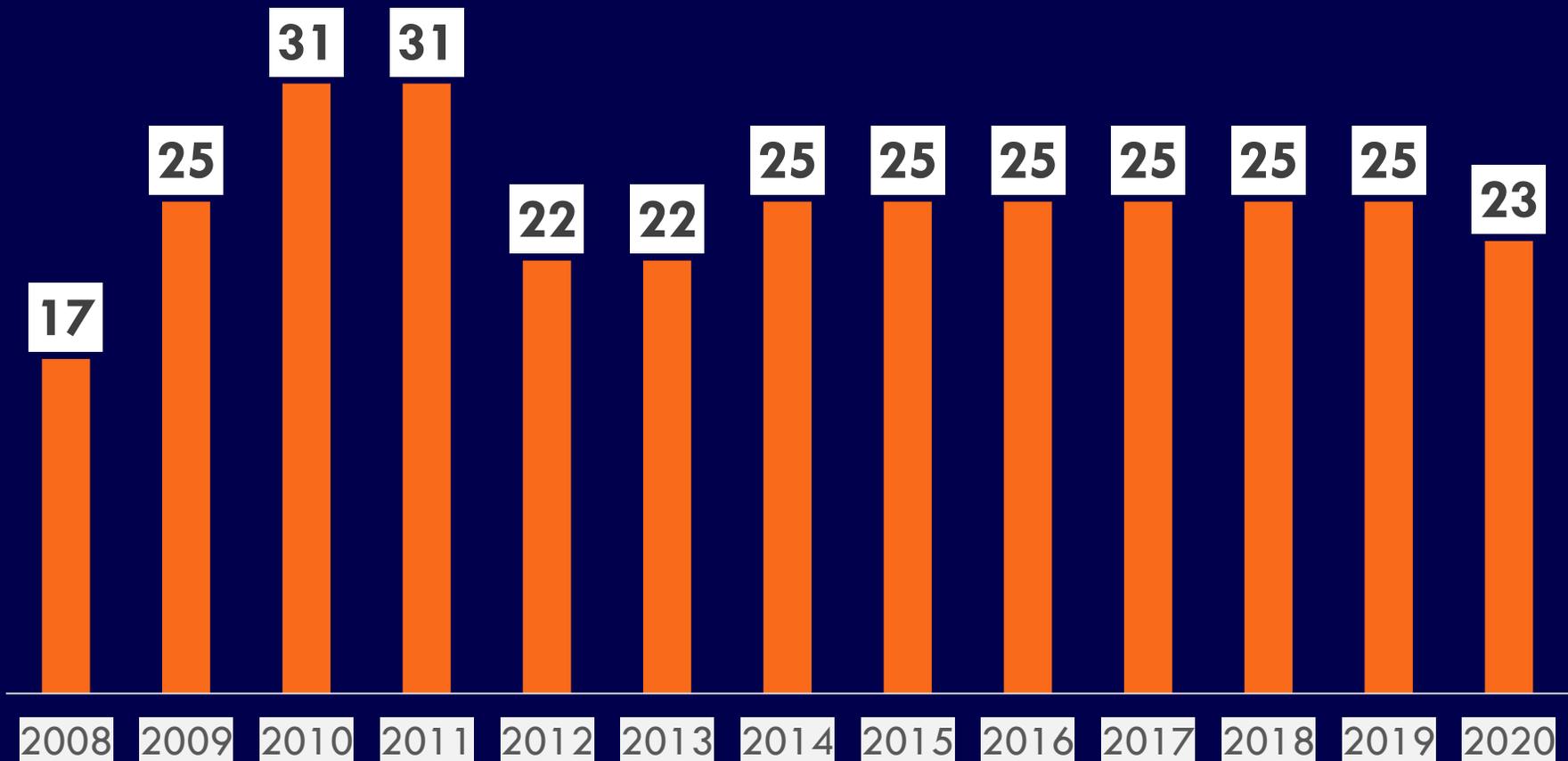
DOT OIG Has \$2.7 Million Annual Budget

- Almost all of budget goes toward personnel costs
- Authorized full-time positions within OIG have decreased from 31 in 2011 to 23 as of February 2020, of which only 17 are filled
- Six vacant auditor positions eliminated July 2020
- DOT supplements its OIG staff with temporary and contract staff

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



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Oversight of DOT OIG Is Assigned to Two Organizations

1. State Board of Transportation Audit Committee
 - five to six members plus the DOT Secretary
2. Council of Internal Auditing within OSBM
 - authority and duties are in GS § 143-747

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Findings



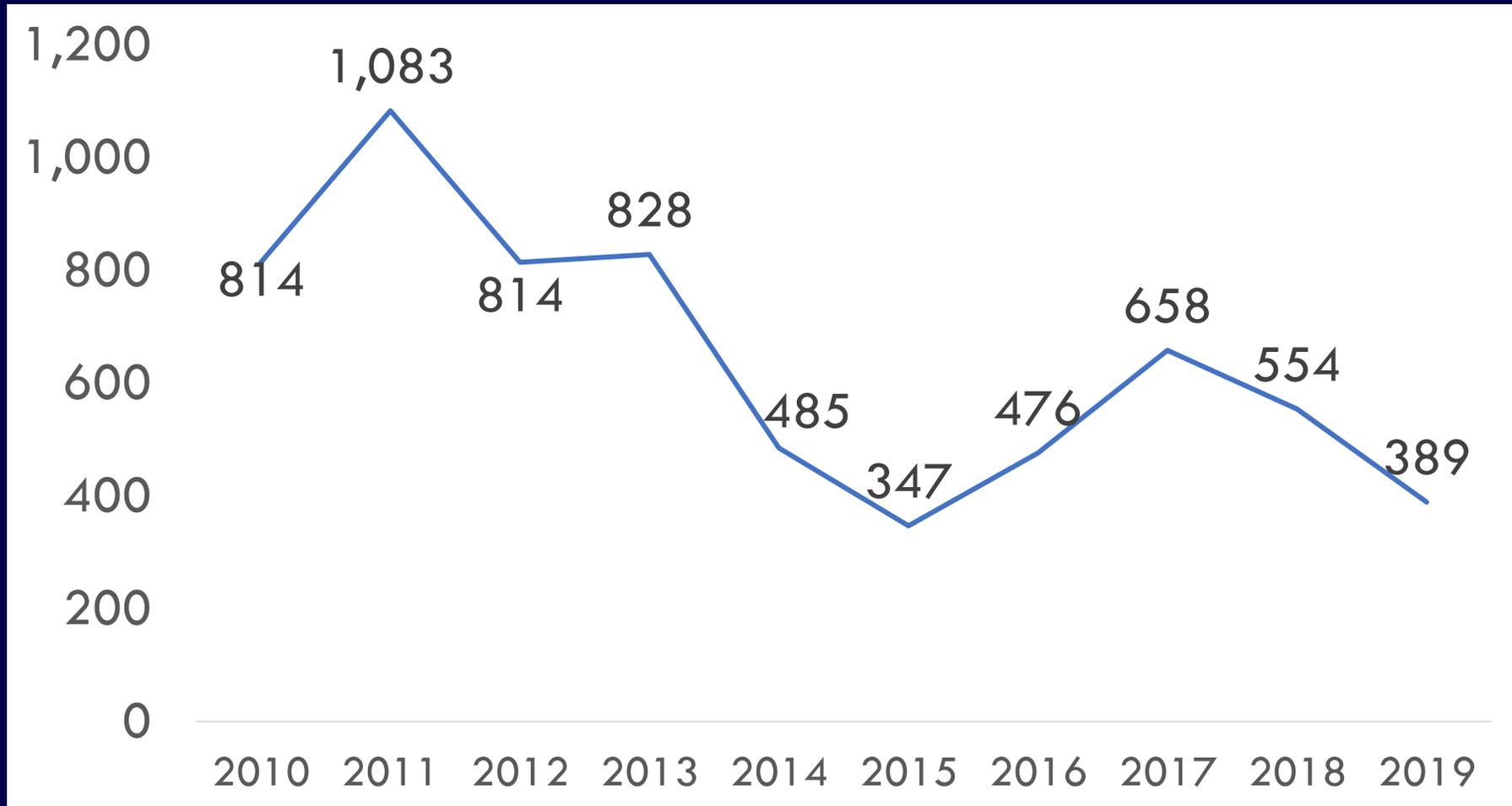
Finding 1

Due to internal oversight shortcomings, DOT OIG 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

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



DOT OIG Performed Zero Performance Audits During 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

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Finding 2

Majority of DOT OIG audits are misaligned with best practices concerning functional boundaries and intra-organizational independence

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Standard 1100 of the International Professional Practices Framework

- Standard 1100 states “Internal audit activity must be independent, and internal auditors must be objective in performing their work”
- Independence is “the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner”

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COSO Model is Intended to Enhance Understanding of Risk Management and Control by Clarifying Roles and Duties

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: 2015 COSO Report

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DOT's Compliance Audits Are Most Closely Aligned with Management Duties

- Violates the recommended scope and independence of the internal audit function
- Could result in management decisions being made by internal auditors themselves

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Finding 3

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

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PED Review of All Council Annual Reports

- PED reviewed all Council reports since 2008 for specific references to the effectiveness of DOT's internal audit operations
- Council reports made no narrative references to the functionality of DOT internal audit

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The Council Has Successfully Accomplished These 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
- Coordinated pooled internal auditing and peer review services to agencies

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Council Has Never Exercised Its Authority To Conduct Hearings

Authorized by N.C. Gen. Stat. § 143-747(c)(11)

By majority vote, Council has authority to

- conduct hearings relative to any attempts to interfere with, compromise, or intimidate an internal auditor;
- **inquire as to effectiveness of any internal audit unit;** and
- issue subpoenas for 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

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Recommendations



Recommendation 1

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

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Recommendation 1 (Cont'd.)

- 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
- Audit Committee should report on implementation of this recommendation to the Joint Legislative Transportation Oversight Committee by October 1, 2021

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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

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Recommendation 2 (Cont'd.)

The Council of Internal Auditing should

- receive testimony from DOT and independent experts and recommend corrective actions to Joint Legislative Transportation Oversight Committee by October 1, 2020
- work jointly with DOT on a general overhaul of OIG and report on implementation of recommendations to Joint Legislative Transportation Oversight Committee by October 1, 2021

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Recommendation 3

The General Assembly should direct the Council of Internal Auditing to establish and monitor compliance with the following standards for all internal audit units within state agencies

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Recommendation 3 (Cont'd.)

The Council of Internal Auditing should

- establish a minimum level of performance audit effort
- 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

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Recommendation 3 (Cont'd.)

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

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Recommendation 3 (Cont'd.)

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

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Summary: Three Findings

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Report available online at
www.ncleg.net/PED/Reports/reports.html

