

STATE OF NORTH CAROLINA

PERFORMANCE AUDIT

OVERSIGHT AND ADMINISTRATION OF THE PERFORMANCE MANAGEMENT SYSTEM

AUGUST 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

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August 19, 2010

The Honorable Beverly Purdue, Governor
Members of the North Carolina General Assembly
Ms. Linda Coleman, Director, Office of State Personnel
Mr. Lanier Cansler, Secretary, Department of Health and Human Services
Mr. Eugene Conti, Secretary, Department of Transportation
Mr. Alvin Keller, Secretary, Department of Correction

Ladies and Gentlemen:

We are pleased to submit this performance audit titled *Oversight and Administration of the Performance Management System*. The audit objectives were to determine (1) whether the performance management system is adequately monitored and (2) whether selected state agencies effectively administer the performance management system. Ms. Coleman, Mr. Cansler, Mr. Conti, and Mr. Keller have reviewed a draft copy of this report. Their written comments are included in the appendix.

The Office of the State Auditor initiated this audit to improve the oversight and administration of the state's performance management system.

We wish to express our appreciation to the staff of the Office of State Personnel, the Department of Correction, the Department of Transportation, and the Department of Health and Human Services for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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SUMMARY

PURPOSE

This report evaluates the monitoring and administration of the state performance management system and makes recommendations so that the Legislature and management at the Office of State Personnel (Personnel), Department of Correction (Correction), Department of Health and Human Services (Health and Human Services), and Department of Transportation (Transportation) can take appropriate corrective action.

RESULTS

During state fiscal year 2008, Correction, Transportation, and most divisions and facilities of Health and Human Services did not monitor their performance management systems. Personnel did not monitor how state agencies administered their performance management systems, and the Legislature did not consider the State Personnel Director's annual report about problems with the performance management system.

State agencies had varying reasons for the lack of monitoring. Both Correction and Health and Human Services made a business decision to shift resources from monitoring their performance management systems in order to implement BEACON. Transportation said the department was implementing new performance management system policies and felt monitoring the system under the old policies was unnecessary. However, none of the agencies made a request with Personnel to forgo their monitoring efforts for fiscal year 2008.

Furthermore, Correction, Health and Human Services, and Transportation did not effectively administer the performance management system. These agencies did not provide measurable performance expectations to employees, prepare written development plans to build employee skills, or adequately document corrective action plans for poor performers.

Because the performance management system is not properly monitored or effectively administered, state supervisors could waste thousands of labor hours (millions of dollars in salaries) preparing and conducting performance appraisals that do not help the State achieve its goals.

For example, two of the State's goals are to "encourage excellence of performance and to maintain the labor market competitiveness necessary to recruit and retain a competent work force" by linking salary increases to employee performance.¹ However, the State may not achieve these goals because the current performance management system and the practice of legislative across-the-board pay increases are not compatible. The State Personnel Director's 2008 "Performance Management Report" notes:

- There is virtually no relationship between performance and pay for state employees due in part to the practice of legislative across-the-board pay increases;

¹North Carolina General Statute 126-7(a)

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- In some state agencies and universities, there is an inverse relationship between pay and performance – less effective employees receive larger increases than effective employees;
- “Across-the-board legislative increases have rendered performance management irrelevant in the minds of most state employees. If this approach to allocating increases is to be continued into the future, then it would be prudent to revisit the purpose, assumptions, and mechanics of performance management and either revamp or eliminate the performance management program.”

Regardless of whether the performance management system is funded by the Legislature, the system should be used to encourage excellence of performance by providing a formal process to communicate performance expectations, give employees quality feedback, and develop employee skills.

Failure to address deficiencies in the State’s performance management system could keep the State from realizing the benefits it seeks – attracting, developing, and retaining top performers. Additionally, the State may fail to develop the skilled workforce necessary to replace workers who retire. Personnel estimates, “9.40% of current state employees will be eligible to retire in 2010 with a dramatic increase to 34.42% in 2015.”² Consequently, fixing the performance management system so that it encourages excellence and develops the State’s workforce is critical.

RECOMMENDATIONS

State agencies should create written monitoring procedures and monitor performance management system administration to ensure compliance with agency policy. As required by state law, state agencies should establish a performance management and pay advisory committee to improve performance management system oversight.

State agencies should provide an objective method to measure employee performance for key responsibilities and results so that employees have a clear understanding of the quality and quantity of work expected from them.

Personnel and state agency policy should require, rather than recommend, written development plans.

State agencies should ensure that corrective action plans are properly completed for all employees who fail to meet performance expectations.

Personnel should actively monitor state agency administration of the performance management system to ensure compliance with state law and Personnel policies. Personnel should identify and provide training to agencies with deficient systems. Personnel should also consider formally presenting its annual report to members of the General Assembly.

² *Cultivating High-Performing Organizations - Work Environment*. NC Office of State Personnel, 2008. Web. June 2010. <<http://www.performancesolutions.nc.gov/motivationInitiatives/index.aspx>>.

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The General Assembly should reexamine the purpose of the performance management and pay advisory committee and more clearly define its purpose and responsibilities to provide a more functional monitoring role even when the system is not funded.

The General Assembly should assess whether the current performance management system benefits the State and consider revising or eliminating the current system.

The General Assembly should consider whether the House State Government/State Personnel Committee and the Senate State and Local Government Committee are the appropriate committees to oversee the performance management system.

AGENCY'S RESPONSE

Agency responses are included in the appendix.

INTRODUCTION

BACKGROUND

North Carolina General Statute 126-7 requires the State Personnel Commission to establish a performance management system to “ensure that career growth recognition awards, cost-of-living adjustments, and performance bonuses are distributed fairly.”³ A performance management system is required under the “graded” and “career-banding” job classification and compensation systems. The performance management system is part of the State’s effort to link salary increases and awards to individual employee performance.

Responsibility for the performance management system is divided among state agencies, the State Personnel Director, and the Legislature. State agencies are responsible for administering the performance management system in accordance with state law, Office of State Personnel policies, and agency specific policies. The State Personnel Director is responsible for monitoring state agency administration of the performance management system, providing training to state agencies, identifying deficient agency performance management systems, and reporting to the Legislature. The Legislature receives an annual report on the performance management system from the State Personnel Director and decides whether and how to act on the Director’s recommendations.

The performance management system is applicable to state employees subject to the State Personnel Act. As of June 30, 2008, there were approximately 98,000 state employees subject to the State Personnel Act.

OBJECTIVES, SCOPE, AND METHODOLOGY

The audit objectives were to determine (1) whether the performance management system is adequately monitored and (2) whether selected state agencies effectively administer the performance management system.

The Office of the State Auditor initiated this audit to improve oversight and administration of the performance management system.

The audit scope included administration of the performance management system during state fiscal year 2008. We conducted the fieldwork from April 2009 to February 2010.

To determine whether the performance management system is adequately monitored, we interviewed personnel at the Office of State Personnel, the Department of Correction, the Department of Health and Human Services, the Department of Transportation, and members

³The State Personnel Manual defines performance management as, “A management process for ensuring employees are focusing their work efforts in ways that contribute to achieving the agency’s mission. It consists of three phases: (a) setting expectations for employee performance, (b) maintaining a dialogue between supervisor and employee to keep performance on track, and (c) measuring actual performance relative to performance expectations.”

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of the General Assembly. We also reviewed the North Carolina General Statutes and the State Personnel Manual.

To determine whether state agencies effectively administer the performance management system, we selected the Department of Correction, the Department of Health and Human Services, and the Department of Transportation for detailed evaluation. The three agencies employ 48 percent of all state employees subject to the State Personnel Act. We selected a random sample of employee performance appraisals at each agency. We also tested all performance appraisals with performance ratings of below good and unsatisfactory at each of the three agencies.

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

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit under the authority vested in the State Auditor of North Carolina by *North Carolina General Statute 147.64*.

FINDINGS AND RECOMMENDATIONS

1. THE PERFORMANCE MANAGEMENT SYSTEM IS NOT ADEQUATELY MONITORED

The Department of Correction (Correction), Department of Transportation (Transportation), and most divisions and facilities of the Department of Health and Human Services did not monitor their performance management systems. The Office of State Personnel (Personnel) did not monitor how state agencies administer their performance management systems, and the Legislature did not review the State Personnel Director's annual performance management system reports.

Lack of Agency Monitoring

Correction, Health and Human Services, and Transportation did not monitor their performance management system as required by Personnel policy and state law.

Specifically, performance management coordinators did not monitor to ensure that the performance management system was administered according to agency policy.⁴ For example, performance management coordinators did not periodically review a sample of performance appraisals to determine whether appraisals were completed properly and timely. Health and Human Services and Correction performance management coordinators had written monitoring policies and procedures; Transportation performance management coordinators did not. Correction and Transportation did not monitor their performance management systems during our audit period, state fiscal year 2008. Health and Human Services did not require its divisions and facilities to monitor during our audit period. Health and Human Services received voluntarily submitted monitoring reports from five of its 31 divisions and facilities.

Personnel requires state agencies to monitor and evaluate their performance management process. The State Personnel Manual reads, "The performance management coordinator (or other designated person) shall monitor the agency administration of the performance management system to ensure compliance with agency policy."

Inadequate monitoring could prevent state agencies from realizing the benefits of a performance management system. Employees may not receive appropriate information or feedback to improve their performance and develop job skills. Additionally, employees may not trust feedback from a system that they perceive as inequitable or inconsistently applied. As a result, agencies may not achieve the stated objectives of the performance management system – to get the work done, develop people, and retain top performers.

State agencies had varying reasons for the lack of monitoring. Performance management coordinators at Correction and Health and Human Services said they were unable to monitor because they were focused on the statewide implementation of BEACON. Both

⁴The State Personnel Manual requires, "Each agency shall designate a person as performance management coordinator with responsibility for coordinating the development and revision of the agency's performance management policy and the implementation and ongoing administration of performance management within the agency."

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agencies made a business decision to shift resources from monitoring their systems in order to implement BEACON. Health and Human Services' coordinator said division coordinators monitored the department's system in state fiscal years 2007 and 2009.⁵ Transportation's coordinator said the department was implementing new performance management system policies and felt monitoring the system under the old policies was unnecessary. However, none of the agencies made a request with Personnel to forgo their monitoring efforts for fiscal year 2008.

Additionally, the agencies did not establish a performance management and pay advisory committee as required by state law. Correction said it had a performance management and pay advisory committee in 2008, but the committee never met. Health and Human Services and Transportation never established a performance management and pay advisory committee.

North Carolina General Statute 126-7(c)(7a) requires state agencies to establish a performance management and pay advisory committee as part of the performance management system. The statute states that the purpose of the committee is to "ensure that salary increases and awards are made in an equitable manner." The statute also states that the committee is responsible for reviewing:

- Agency salary increase and award policies to determine whether this section and any guidelines promulgated by the State Personnel Commission have been adhered to;
- Agency training and education programs to determine whether all employees receive appropriate information;
- Performance appraisal ratings within the department, agency, or institution to determine whether an equitable distribution has been made.

Furthermore, the statute requires the committee to meet at least semiannually and submit a written report following each meeting to the head of the department and to Personnel. The report should "include recommendations for changes and corrections in the administration of the performance management system."⁶

State agencies also had varying reasons for the lack of a performance management and pay advisory committee. The performance management coordinators at Correction and Health and Human Services did not have a clear understanding of the committee's purpose. They viewed the committee's purpose as only to distribute performance rewards. Because the General Assembly has not funded the performance reward system, Correction and Health and Human Services did not consider it necessary to establish a performance management and pay advisory committee. Transportation's performance management coordinator was unaware that state law required agencies to establish a

⁵ While we were provided evidence of monitoring, We did not audit the quality of monitoring efforts for state fiscal years 2007 and 2009.

⁶ *North Carolina General Statute 126-7(c)(7a)*

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committee. Additionally, Personnel has not actively pursued committee reports from the three agencies.

The performance management and pay advisory committee has statutory responsibilities to fulfill regardless of whether funding is available to award performance-based increases or bonuses. Although the system has not been funded since 2001, the statute still requires agency committees to review training and education programs for the performance management system and review rating distributions within the agency. In addition, the statute requires the committee to evaluate the agency's administration of the performance management system and report results semiannually to the agency head and Personnel. Personnel agrees that the committee is responsible for these functions even when performance pay is not funded. The committee could perform other tasks to supplement agency monitoring activities. For example, along with reviewing rating distributions within the agency, the committee could develop strategies to address inflated ratings. Also, the committee could examine issues noted in this report and Personnel's annual report, and take corrective actions.

Lack of Office of State Personnel Monitoring

Personnel did not monitor how state agencies administered their performance management systems as required by state law.

Personnel's performance management system policy requires state agencies to:

- Communicate performance expectations to employees;
- Conduct annual performance appraisals;
- Address poor performance and support employee development;
- Train managers and supervisors how to manage employee performance;
- Monitor and evaluate the performance management process.

However, Personnel did not have procedures in place to determine whether state agencies are complying with the performance management system requirements. For example, Personnel did not:

- Interview state employees to determine if performance expectations were clearly communicated;
- Sample and review performance appraisals for completeness and timeliness;
- Sample corrective action plans to determine if agencies effectively address poor performers;
- Review state agency performance management training materials and documentation to determine that training was conducted;

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- Determine if state agencies properly monitored their performance management process.

North Carolina General Statute 126-7 requires Personnel to:

- Monitor and evaluate the performance of each department, agency, and institution in the administration of its appraisal system and the distribution of salary increases and awards within each department, agency, and institution and across state government;
- Recommend to the General Assembly for its approval sanctions to be levied against departments, agencies, and institutions that have deficient performance appraisal systems or that do not link salary increases and awards to employee job performance.

To comply with state law, Personnel analyzes data from BEACON, the state's human resources and payroll system. However, this procedure does not provide Personnel with sufficient evidence to determine whether state agencies are properly administering their performance management systems or to identify deficient systems.

Personnel said it did not monitor because of other priorities and a lack of resources. Personnel stated that the former State Personnel Director focused on other areas and did not assign resources to monitor agencies' appraisal systems. Personnel only had one employee assigned to provide technical support, offer training, and communicate the importance of the performance management system to state agencies.

Without proper monitoring, Personnel cannot identify and correct poorly administered state agency performance management systems. Furthermore, state agencies could start to perceive the performance management system as an administrative task rather than a system to develop the agency workforce and align agency activities with agency goals.

Lack of Legislative Monitoring

The Legislature does not review the annual report from the State Personnel Director to identify problems with the performance management system and decide on corrective action. The State Personnel Director submits a report to the House State Government/State Personnel Committee and the Senate State and Local Government Committee. However, committee members said they did not read the report.

Legislators should review reports from the executive branch of state government to ensure that programs are administered in accordance with state law and legislative intent. *North Carolina General Statute 126-7* requires the State Personnel Director to submit an annual report that evaluates the "performance of each department, agency, and institution in the administration of its appraisal system" to the General Assembly. The law requires

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the State Personnel Director to include “recommendations for improving the performance appraisal system and alleviating inequities” in the report.⁷

Because legislators do not read the reports, the General Assembly may not be aware of problems with the performance management system. For example, one goal of the performance management system is to link salary increases to performance. However, the 2008 “Performance Management Report” determined:

- There is virtually no relationship between performance and pay for state employees due in part to the practice of legislative across-the-board pay increases;
- In some state agencies and universities, there is an inverse relationship between pay and performance – less effective employees receive larger increases than effective employees;
- Poor performers are rarely fired from state agencies, and they receive the same legislative pay increases as employees who meet or exceed performance expectations. The report also highlights problems with performance rating accuracy;
- Employee performance ratings are “inflated” with 81% of state employees receiving ratings of outstanding or very good and less than 1% of state employees failing to meet expectations. According to the report, in an “ideal” distribution only about 35% of employees would exceed performance expectations and about 15% would fail to meet expectations;
- “Given the general tendency toward inflated ratings, it is likely that there are many more poor performers lurking among those who are currently rated ‘good’ or better.”

Furthermore, legislators may be unaware of recommendations to modify or improve the performance management system. For example, the 2008 “Performance Management Report” states:

Across-the-board legislative increases have rendered performance management irrelevant in the minds of most state employees. If this approach to allocating increases is to be continued into the future, then it would be prudent to revisit the purpose, assumptions, and mechanics of performance management and either revamp or eliminate the performance management program.

The time and money spent administering the performance management system could be wasted if known problems are not corrected. Supervisors do not keep records of the time they spend preparing and conducting performance appraisals. However, supervisors at

⁷ Personnel writes, “The report’s intent is to describe the distribution of employees’ performance ratings and the relationship between these ratings and important employee demographics and other factors. It also analyzes racial differences in performance ratings, what happens over time to poor performers, and the relationship between performance and changes in base pay when both legislative increases and in-range adjustments are included.”

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Correction, Health and Human Services, and Transportation estimate that they spend between 4.25 and 6.5 hours preparing and conducting performance appraisals for each employee. Based on supervisor time estimates, each agency's average hourly supervisor salary, and the number of employees appraised, the performance appraisal process could cost the following in supervisor time and salaries annually:⁸

- *Health and Human Services:* 93,470 labor hours, \$2.5 million in salaries;
- *Correction:* 81,310 labor hours, \$1.5 million in salaries;
- *Transportation:* 50,112 labor hours and \$1.3 million in salaries.

The costs listed above only include the supervisor's time spent preparing and conducting performance appraisals. They do not include labor hours and salaries expended for:

- Designing appraisal documents and obtaining Personnel's approval;
- Preparing, conducting, and attending performance appraisal training;
- Management reviews of appraisal documents above the supervisor level;
- Employee participation in the appraisal process;
- Follow-up on corrective action plans;
- Follow-up on employee development plans;
- Human Resource Department activities.

Members of the House State Government/State Personnel Committee and the Senate State and Local Government Committee said they did not read the State Personnel Director's annual report because of the number of reports they receive. Members said they receive hundreds of annual reports and did not have time to read them all. One member said that there were so many annual reports that legislators could spend all day every day just reading reports. To bring attention to the performance management system, committee members recommended that Personnel should meet with and brief the committees on the report.

Members of the House State Government/State Personnel Committee and the Senate State and Local Government Committee also suggested that the report should be sent to a different committee. Members said their committees were created to hear and review bills. Committee members said the General Assembly should be kept informed about the performance management system and suggested that the State Personnel Director should submit the annual report to a different committee such as an oversight committee, the

⁸To calculate salary cost, we surveyed a random sample of supervisors at the three agencies and asked them to estimate the time they spent preparing and conducting performance appraisals. We surveyed 117 to 124 supervisors per agency, but only received 63 to 82 responses per agency (a 54% to 66% response rate). Based on the survey, we calculated the median time spent per appraisal and multiplied it by the total number of employees appraised and the median supervisor hourly salary per agency for fiscal year 2008. The results are not statistically valid and only provide an indication of potential costs.

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Joint Legislative Commission on Government Operations, or the full Appropriations Committee.

Recommendations:

State agency performance management coordinators should create written monitoring procedures and monitor performance management system administration to ensure compliance with agency policy. As required by state law, state agencies should establish a performance management and pay advisory committee to improve performance management system oversight.

Personnel should actively monitor state agency administration of the performance management system to ensure compliance with state law and Personnel policies. Personnel should identify and provide training to agencies with deficient systems. Personnel should also consider formally presenting its annual report to members of the General Assembly.

The General Assembly should reexamine the purpose of the performance management and pay advisory committee and more clearly define its purpose and responsibilities to provide a more functional monitoring role even when the system is not funded.

The General Assembly should assess whether the current performance management system benefits the State and consider revising or eliminating the current system.

The General Assembly should consider whether the House State Government/State Personnel Committee and the Senate State and Local Government Committee are the appropriate committees to oversee the state's performance management system.

2. AGENCIES DID NOT EFFECTIVELY ADMINISTER PERFORMANCE MANAGEMENT SYSTEM

The Department of Correction (Correction), Department of Health and Human Services (Health and Human Services), and Department of Transportation (Transportation) did not provide measurable performance expectations, prepare written development plans, and adequately document corrective action plans for poor performers.⁹

Did Not Provide Measurable Performance Expectations

Correction, Health and Human Services, and Transportation performance appraisal documents did not always provide an objective method (such as quantity, quality, timeliness, frequency, or cost measures) to measure employee performance for "key responsibilities and results."

⁹The State Personnel Manual defines a development plan as, "An action plan for enhancing an employee's level of performance in order to excel in the current job or prepare for new responsibilities." The manual defines a corrective action plan as, "A short-term action plan that is initiated when an employee's performance fails to meet expectations. Its purpose is to achieve an improvement in performance."

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For example, in a sample of performance appraisal documents:

- *Correction:* 697 out of 697 (100%) key responsibilities and results were listed with no measurement criteria.
- *Health and Human Services:* 420 out of 636 (66%) key responsibilities and results were listed with no measurement criteria.
- *Transportation:* 234 out of 664 (35%) key responsibilities and results were listed with no measurement criteria.

The State Personnel Manual states that one purpose of the performance management system is to ensure that “employees have a clear understanding of the quality and quantity of work expected from them.” The manual requires supervisors to “establish expectations regarding their employees’ performance, specify how employees’ actual performance will be measured and their success determined.” Furthermore, the Office of State Personnel recommends that “results expectations are verifiable – they should not be vague. There should be a way to verify whether or not they have been achieved.”¹⁰

Failure to provide measurable, verifiable performance expectations can result in perceptions of inequity and lowered productivity. Without clear and measurable expectations, employees could feel that they have little or no control over the performance ratings they will receive - that ratings are subjective and determined solely by the supervisor’s perception of the employee’s work. Also, a lack of clear and measurable performance expectations (goals) can prevent employees from achieving higher levels of productivity. The Office of State Personnel writes, “In an analysis of dozens research studies, it was found that companies that introduced systematic goal-setting programs enjoyed an average 39% increase in productivity. Goal setting is the central pillar of performance management.”¹¹

Did Not Prepare Written Development Plans

Supervisors did not prepare written employee development plans to “build employee’s skills so that they can become more effective in their current jobs, get ready to take on greater responsibilities, or prepare to move into other positions.”¹² Based on a random sample of performance appraisals:

- *Transportation:* 127 out of 131 (97%) employees did not have written development plans.
- *Correction:* 79 out of 133 (59%) employees did not have written development plans.

¹⁰ *Cultivating 2*, at Performance Management.

¹¹ *Cultivating 2*, at Performance Management.

¹² *Cultivating 2*, at Performance Management.

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- *Health and Human Services*: 58 out of 125 (46%) employees did not have written development plans.

While not mandated by state policy, supervisors are encouraged to support employee development by creating individual development plans for employees who express interest. The State Personnel Manual states:

Many employees may express interest in growing in their current positions or in furthering their careers in state government. Supervisors shall work with them to identify strengths and weaknesses and, if appropriate, to help them prepare an individual development plan. Individual development plans may specify how employees can more fully apply their strengths in their current positions, build up areas of weakness, enhance their performance in their current positions, or develop the skills and experience they will need for possible future assignments.

Additionally, development plans should be written. Personnel recommends, “A development plan should be a written document because major development efforts typically do not work if they are just talked about.” Personnel further states, “Development is more likely to happen if you commit the development plan to writing, identify the skill or knowledge that will be the focus of the plan, and describe how developmental success will be measured.”¹³

Without written employee development plans, employees may not acquire higher skills to further their careers or grow to meet the State’s employment needs. As a result, state agencies may fail to develop the skilled workforce necessary to replace workers who retire. Personnel estimates, “9.40% of current state employees will be eligible to retire in 2010 with a dramatic increase to 34.42% in 2015.”¹⁴ Consequently, developing the State’s workforce is critical.

Did Not Adequately Document Corrective Action Plans

Correction, Health and Human Services, and Transportation supervisors did not properly prepare corrective action plans to address poor employee performance. As noted in the State Personnel Director’s 2008 “Performance Management Report,” state employee performance ratings are inflated and less than 1% of state employees received a “below good” or “unsatisfactory” rating. For the small number of employees who received corrective action plans, however, supervisors did not specify steps for improvement, list consequences for failure to improve, and follow-up on the corrective action plans. Based on a review of all Correction, Health and Human Services, and Transportation performance appraisals with a rating of below good or unsatisfactory:

Health and Human Services (61 appraisals)

- 41 (67%) did not specify consequences for failure to improve;

¹³ *Cultivating 2*, at Performance Management.

¹⁴ *Cultivating 2*, at Work Environment.

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- 25 (41%) did not have evidence of a follow-up meeting;
- 3 (5%) did not include steps for improvement.

Transportation (29 appraisals)

- 17 (59%) did not specify consequences for failure to improve;
- 13 (45%) did not have evidence of a follow-up meeting;
- 5 (17%) did not include steps for improvement.

Correction (49 appraisals)

- 23 (47%) did not specify consequences for failure to improve;
- 16 (33%) did not have evidence of a follow-up meeting;
- 1 (2%) did not include steps for improvement.

The State Personnel Manual requires supervisors to “document the performance deficiency and take actions, including (if appropriate) disciplinary action, to assure that performance expectations will be met within a reasonable period of time.” To address poor performance, state policy requires supervisors to prepare a corrective action plan that specifies the:

- Performance problem;
- Steps to be taken to improve performance, including the timeframe for improvement;
- Consequences of failure to improve;
- Follow-up date.

If poor employee performance is not documented and corrected, a state agency could retain poor performers in its work force. As a result, the State may:

- Waste state funds because poor performers continue to receive their pay, and they receive the same legislative across-the-board pay increases as good performers receive;
- Suffer a reduction in employee morale because state employees who are committed to excellence see poor performers retain their jobs and receive pay increases;
- Have a difficult time removing poor performers because adequate documentation may not be available to successfully defend against employee grievances and other legal action;
- Forfeit opportunities to improve productivity and more efficiently deliver services to North Carolina’s citizens.

FINDINGS AND RECOMMENDATIONS

Recommendations:

State agencies should provide an objective method to measure employee performance for key responsibilities and results so that employees have a clear understanding of the quality and quantity of work expected from them.

Personnel and state agency policy should require, rather than recommend, written development plans.

State agencies should ensure that corrective action plans are properly completed for all employees who fail to meet performance expectations.

Auditor Comments

The Office of the State Auditor intends that the Governor, the General Assembly, and the citizens of North Carolina receive only complete and accurate information from reports it issues. Additionally, Generally Accepted Government Auditing Standards state,

“When the audited entity’s comments are inconsistent or in conflict with the findings, conclusions, or recommendations in the draft report, or when planned corrective actions do not adequately address the auditor’s recommendations, the auditors should evaluate the validity of the audited entity’s comments. If the auditors disagree with the comments, they should explain in the report their reasons for disagreement.”

To ensure the availability of complete and accurate information and in accordance with auditing standards, the following comments are made to the response received from the Department of Health and Human Services to *Finding 1: The Performance Management System is Not Adequately Monitored*.

Health and Human Services responded in part, “It should be noted that during this time period [state fiscal year 2008], 99% of all employees received a performance rating by the deadline.”

However, the reader should recognize the distinction between an employee receiving a rating and the lack of agency monitoring to ensure that ratings are substantiated. As pointed out in this report, 26 of 31 divisions and facilities at Health and Human Services did not perform monitoring functions to ensure that the appraisals that support these ratings were properly conducted and documented in accordance with State and Health and Human Services policies and procedures.

Health and Human Services also responded in part, “Based on our experience and feedback from senior DHHS managers, we feel the hours noted in the report for PMS administration is overstated.” Further, the Health and Human Services said, “We feel that the resultant PMS related cost shown in the report is overstated.”

It is important to mention that the inclusion of labor hours and costs in this report was made solely for the purpose of demonstrating the cost of the performance management process to the State and not intended to judge agency efforts. As explained in footnote 7 of this report, reported labor hours and costs were determined based on estimates made by a random sample of Health and Human Services supervisors who execute the performance management process.

Health and Human Services said that management’s “only tool has been to give employees non-monetary recognition for doing their work” because the performance management system has not been funded to provide performance bonuses to employees.

APPENDIX

The Auditor recognizes that “non-monetary recognition” is a way of rewarding high-performing employees. Good examples of non-monetary recognition include employee of the month programs, keepsakes, letters of appreciation, honorary awards, or a simple pat on the back and a “thank you.” However, agencies should not reward employees by giving them higher ratings than justified, which compromises the performance management process and leads to inflated ratings.

The Governor, Legislators, and the citizens of North Carolina should consider the clarification provided above when using this report to evaluate Health and Human Services’ response and holding government managers accountable for their programs.



**STATE OF NORTH CAROLINA
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**BEVERLY EAVES PERDUE
GOVERNOR**

**LINDA D. COLEMAN
STATE PERSONNEL DIRECTOR**

July 15, 2010

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Ms. Wood:

In connection with your office's audit of the statewide performance management system, we are in substantial agreement with the recommendations that pertain directly to the Office of State Personnel (OSP). These recommendations are listed below along with the corrective actions we propose to take:

1. "Personnel [OSP] should actively monitor state agency administration of the performance management system to ensure compliance with state law and Personnel policies."

The monitoring of agencies' performance management practices will be performed by OSP's Equal Employment Opportunity, Diversity and Compliance Division. The monitoring / auditing function within OSP has been inactive for several years. In early 2011 the EEO, Diversity and Compliance Division will begin performing audits that include review of performance management practices.

2. "Personnel [OSP] should identify and provide training to agencies with deficient systems."

As our EEO, Diversity and Compliance Division identifies deficiencies in performance management systems in agencies, the Performance Solutions Division will be engaged to consult with the agency in question to assist or give direction in correcting the deficiencies.

3. "Personnel [OSP] should also consider formally presenting its annual report to members of the General Assembly."

We concur with this recommendation. Presenting the report to the General Assembly would afford us the opportunity to discuss issues concerning performance management

The Honorable Beth A. Wood
July 15, 2010
Page 2

as well as the relationship between performance management and other elements of the human resource management system (e.g., compensation, workforce development).

4. "Personnel [OSP] and state agency policy should require, rather than recommend, written development plans."

This recommendation will be incorporated in the next revision of the statewide policy. The first triennial review of the performance management system, underway now in each of the agencies, will be completed in December 2010. The Review is likely to identify other needed policy revisions. The development plan requirement will be included in the policy revision process at this time. When development planning is added as a requirement, we will take care to provide the guidance and training necessary to avoid mere compliance with the requirement or excessive reliance on formal training programs as a way to satisfy the requirement.



Linda D. Coleman, State Personnel Director



Lynn Summers, HR Consultant, Statewide Performance Management Coordinator



North Carolina Department of Health and Human Services

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Beverly Eaves Perdue, Governor

Lanier M. Cansler, Secretary

July 30, 2010

Beth A. Wood, CPA, State Auditor
Office of the State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Ms. Wood:

Thank you for the opportunity to review the draft audit report of the Performance Management System for the Department of Correction (DOC), Department of Health and Human Services (DHHS), Department of Transportation (DOT) and the Office of State Personnel (OSP). Our comments will be limited to the portions of the report that address DHHS matters.

1. THE PERFORMANCE MANAGEMENT SYSTEM IS NOT ADEQUATELY MONITORED

It is very important to note that the work cycle selected for review (July 1, 2007- June 30, 2008) covered the time period the State was implementing the BEACON payroll system. DHHS was probably the most adversely affected State department due to the complexities of payroll associated with the 18,000 employees who work in our hospitals, facilities and various divisions/offices. During that period, the criticalities of ensuring that our employees were paid correctly and on time was of utmost concern to everyone. Thousands of hours were required to investigate pay questions and make appropriate corrections. It should be noted that during this time period, 99% of all employees received a performance rating by the deadline.

It should also be noted that thousands of supervisors have carried out the performance management process without all the tools cited in the OSP Career Growth Recognition Award (CGRA) policy to support performance merit money or bonuses.

Lack of Agency Monitoring

DHHS has had a monitoring process in place for twenty years. That process included a role definition for local performance management coordinators and a requirement that the individual divisions/offices conduct an audit of 10% of the agency's workplans.

For the work cycle 20, due to the extreme workload occurring in the HR offices related to the BEACON implementation as noted above, no action was taken against those divisions/offices who did not submit local audits due to employee time constraints. Broughton Hospital, Murdoch Center, Division of Vocational Rehabilitation, Division of Services for the Blind and Division of Services for the Deaf/Hard of Hearing voluntarily submitted audit reports.

The audit references the CGRA statute that the purpose of the board is to “ensure that salary increases and awards are made in an equitable manner.”

G.S. 126.7 Article 2 (a2)

(1) "Career growth recognition award" means an annual salary increase awarded to a State employee whose final annual performance appraisal indicates job performance that meets or exceeds management's expectations and performance requirements;

The Article is referring to performance management and does not reference all HR actions such as promotions. The Department did not deem it necessary to include all salary decisions as part of the Performance Management and Pay Advisory Committee.

DHHS provided a copy of both the process and procedures for the Committee that were established in 1999. The Committee last met in 2003. At that time, the members recommended that the Committee not meet again since there was no pay for performance and no significant issues that came out of the OSP audit. They felt it was not a prudent use of the State's resources to bring committee members to Raleigh when there was no performance pay to discuss. The cost to hold the meeting would be approximately \$6,000 per meeting in time and mileage. The Office of State Personnel did not require submission of reports from the Committee and management decided not to hold the Committee meeting. No evidence of a system-wide disparity was noted by OSP for the '07-08 work cycle.

In the future, DHHS will hold the Performance Management and Pay Advisory Committee meeting as mandated by general statute during this fiscal year.

Lack of Legislative Monitoring

The report also states that “Supervisors do not keep records of the time they spend preparing and conducting performance appraisals.” Further, it reports that supervisors at DOC, DHHS, DOT estimate that they spend between 4.25 and 6.5 hours preparing and conducting performance appraisals for each employee. Based on our experience and feedback from senior DHHS managers, we feel the hours noted in the report for PMS administration are overstated. As one would expect, workplans normally vary little from year to year and merely need to be copied and tweaked as opposed to brand new workplan development. Likewise, communication between employees and supervisors occur on a daily basis and there is little new to discuss during evaluations. The plan and appraisals should not take as long as indicated in the report. We feel that the resultant PMS related cost shown in the report is overstated.

The report also suggests that supervisors waste taxpayer money by not adequately utilizing the PM system. While there are definite benefits from a PM system, the lack of performance pay does limit its

effectiveness and usefulness. At the same time, the PM system does offer a formal opportunity to acknowledge the work that employees perform. Due to our tight economy and reduced budgets, numerous positions have remained vacant for extended periods of time and existing employees have taken on additional duties or hours. Managers have not been able to recognize superior performance through the CGRA. Their only tool has been to give employees non-monetary recognition for doing their work, often with out-of-date tools or limited resources, and assuming additional duties and workloads for vacant positions.

2. AGENCIES DID NOT EFFECTIVELY ADMINISTER PERFORMANCE MANAGEMENT SYSTEM

Did not provide Measurable Performance Expectations.

The report cited that DHHS performance appraisal documents did not always provide an objective method (such as quantity, quality, timeliness, frequency, or cost measures) to measure employee performance for “*key responsibilities and results.*” Current DHHS training materials and Online Workplan Guide both cover how workplans are to be measured and communicated.

At the time of the audit, expectations were often written to reflect job tasks rather than results, i.e. a key responsibility. For example, an employee is required to follow a set of policies. The measure (quality) is against an established standard. The expectation then was written as: “*Ensure policies and procedures are carried out according to standard operating procedures.*”

Over the past three years, DHHS has been transitioning to workplans that reflect outcomes rather than the completion of tasks. The Department reviewed the training materials with OSP who also observed the training.

Did Not Prepare Written Development Plans

Neither OSP nor DHHS policy requires employees to have a development plan. The DHHS workplan does provide space for a development plan and supervisors are encouraged to offer developmental opportunities to employees but funding restrictions make this difficult. The majority of the Department did have development plans or 54% as cited in the sample. In '07-08, DHHS employees completed over 620,000 hours of training and thus were provided training and development opportunities.

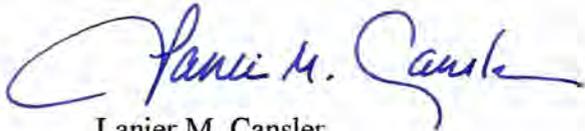
Did Not Adequately Document Corrective Action Plans

It would be more accurate to note that in some cases, the Department did not complete all the required elements of corrective action plans for various reasons. (95% of the sample did include steps for improvement). Many of the improvement plans were also written as memorandums during the year and kept in employee relations files. The Department will note in its training and audit process for the coming year the need to further define corrective actions.

Ms. Beth Wood, State Auditor
July 30, 2010
Page 4 of 4

Again, thank you for the opportunity to review and comment on the draft audit findings.

Sincerely,



Lanier M. Cansler

cc: Dan C. Stewart
Kathy Gruer



STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

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

BEVERLY EAVES PERDUE
GOVERNOR

EUGENE A. CONTI, JR.
SECRETARY

July 19, 2010

The Honorable Beth A. Wood, CPA
State Auditor
Office of State Auditor
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Auditor Wood:

Thank you for the opportunity to respond to the Performance Audit of Oversight and Administration of the Performance Management System. I have reviewed the report and offer the following comments:

1. The Performance Management System Is Not Adequately Monitored

Recommendation: State agency performance management coordinators should create written monitoring procedures and monitor performance management system administration to ensure compliance with agency policy. As required by Personnel policy, state agencies should establish a performance management and pay advisory committee to improve performance management system oversight.

Response: The Department of Transportation has implemented a new Performance Management System called Results Based Performance Management. This system was developed by a Department task force with consultation from the North Carolina Office of State Personnel Performance Solutions Division. It is metric driven with clear and measurable job expectations and has been approved by the State Personnel Commission. The new system follows a written plan of monitoring and interaction between our Human Resource's office, management, employees and the Office of State personnel. An annual audit consisting of a ten percent sample will be conducted along with management and employee focus groups. We have implemented a Performance Management and Pay Advisory Committee as required by North Carolina General Statute 126-7(c)(7a).

The Honorable Beth A. Wood, CPA
July 19, 2010
Page 2

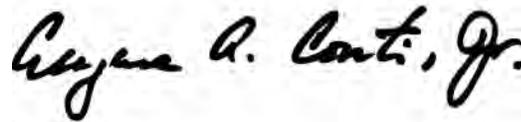
2. Agencies Did Not Effectively Administer Performance Management System

Recommendation: State agencies should provide an objective method to measure employee performance for key responsibilities and results so that employees have a clear understanding of the quality and quantity of work expected from them.

Response: The Results Based Performance Management system does provide an objective method (such as quantity, quality, timeliness, frequency, or cost measure) to measure employee job performance. The Department developed our work metrics through classification based work groups guided by management and our Director of the Performance Metrics Management office. Our Department portal provides performance management information with tools such as the metric menu and scorecards. This information is available for employees and managers. The Results Based Performance Management system also has tools such as the Individual Development Plan and the Corrective Action Plan for use by managers in developing their employees.

Thank you again for the opportunity to respond to the recommendations in the report and for the expertise and professionalism demonstrated by your staff in conducting this performance audit. I appreciate the work of the Office of the State Auditor in helping the Department achieve its goals and become aware of additional opportunities to improve our operations and reduce expenditures.

Sincerely,



Eugene A. Conti, Jr.

EAC:ss

cc: Jim Trogdon, PE, Chief Operations Officer
Ellis Powell, PE, Chief of Staff
Angela Faulk, Human Resources Director
Bruce Dillard, Inspector General



North Carolina Department of Correction

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Governor

Alvin W. Keller, Jr.
Secretary

July 28, 2010

The Honorable Beth A. Wood, State Auditor
2 South Salisbury Street
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Raleigh, NC 27699-0601

Dear Ms. Wood:

This is in response to your audit of the performance management system of the North Carolina Department of Correction. The Executive Management Team, Performance Management Program staff and I have reviewed the report and offer the following responses regarding each finding and recommendation:

1. The Performance Management system is not adequately monitored.

- a. **Auditor's Findings: Agency did not monitor to ensure that the Performance Management system was administered correctly.**

Auditor's Recommendations: "State agency performance management coordinators should create written monitoring procedures and monitor performance management system administration to ensure compliance with agency policy."

Agency Response: We agree that during the period being audited (FY 2007-2008), the N.C. Department of Correction did not perform Performance Management System audits. During that year, the priority as set forth by the Governor was the implementation of BEACON/SAP, the state's new HR/Payroll system. Consequently, the department began preparation of the BEACON/SAP initiative and all regular, recurring duties of DOC's performance management and training staff were suspended and resources reassigned for the duration of the BEACON implementation including monitoring of the Performance Management system.

The Honorable Beth A. Wood, State Auditor
 Performance Management System Audit Report Response
 Page Two

Agency Recommendation: The Department recognizes the importance of monitoring the administration of the Performance Management System. The N.C. Department of Correction has a Performance Management Trend Analysis Monitoring Program in place to monitor the administration of the Performance Management Program. The Department of Correction will continue to use the Trend Analysis tool to monitor the Performance Management Program. The department's Performance Management staff in partnership with the Management Information System staff began development of a web-based tracking tool. The web-based tracking tool is an enhancement to our monitoring program and the department expects to expand the use of the web-based tracking program which will enable managers to more closely monitor the Performance Management Program and ensure the required discussions occur on time. The department will review and enhance the written procedures to incorporate elements that better describe the processes and activities for monitoring the Performance Management System.

b. Auditor's Findings: **The Performance Pay Advisory Committee did not meet.**

Auditor's Recommendations: "State agencies should establish a performance management and pay advisory committee to improve performance management system oversight."

Agency Response: We agree that during this period of review, the Department of Correction's Performance Pay Advisory Committee did not meet during fiscal year 2007-2008.

Agency Recommendation: The current Executive Management Team should appoint members to serve as the Performance Pay Advisory Committee.

2. **Agencies did not effectively administer performance management system.**

a. Auditor's Findings: **Agency did not provide measurable performance expectations.**

Auditor's Recommendation: "State agencies should provide an objective method to measure employee performance for key responsibilities and results so that employees have a clear understanding of the quality and quantity of work expected from them."

Agency Response: We agree that measurable performance expectations are not maintained in the work plans. The details and measures relevant to quality, quantity, and timeliness are found in each operating division and work location within the Department of Correction. A request for technical assistance from the U.S. Department of Justice, National Institute of Correction was made and services provided. Technical assistance was provided to the Department of Correction, State of North Carolina, under the auspices of the Prisons Division of the National Institute of Corrections for the purpose of providing consultative and advisory services in the design, development implementation and administration of the performance management system. Technical Assistance Report (NIC Technical Assistance No. 95P1046) stated the following:

The Honorable Beth A. Wood, State Auditor
Performance Management System Audit Report Response
Page Three

1. The selection of job categories in order to develop work standards in DOC-NC seems reasonable and appropriate.
2. The use of subject matter experts and the process of writing and developing work plans for all positions in each job category follows standard operating procedures for establishing the content validity of performance standards.
3. It is recommended that a structured performance tracking system, such as a performance log be used for managing and documenting performance. A performance log which documents positive as well as negative performance behaviors can serve as an excellent communication tool between supervisor and employee.

Based on consultation with the National Institute of Correction and continuous collaboration with the Office of State Personnel, performance standards (compliant according to standards at the time of development) for each performance level were developed, reviewed by the Office of State Personnel, and implemented within the Department of Correction.

Agency Recommendation: In addition to this recent audit review, the following initiatives are taking place and may further impact the Performance Management Program in the Department of Correction:

1. The Office of State Personnel is conducting a Triennial Performance Program Review with a completion date of October 2010.
2. A new classification and pay system is being developed by the Office of State Personnel
3. The Department's second largest division, the Division of Community Correction is implementing evidence based practices which include performance measures, which will result in a modification to their standards in the near future.

The Department of Correction recommends that the agency's current procedure regarding the content and ability to revise performance standards continues. Once the initiatives identified in items 1-3 above are developed and implemented, it is reasonable to conduct a review of the performance management standards to analyze and identify the impact and potential changes that need to be made.

b. Auditor's Findings: **The agency did not prepare written development plans.**

Auditor's Recommendation: "Personnel and state agency policy should require, rather than recommend, written development plans."

The Honorable Beth A. Wood, State Auditor
Performance Management System Audit Report Response
Page Four

Agency Response: We agree that at the time of this review, state and agency policy did not require written development plans.

The Department of Correction has a method of documenting Written Development Plans. Specifically, the Work Plan Discussion Form (11/02); Section (B): Employee Plans for Career Development and Training is where the department records employee development plans. While completion of Section B, Employee Plans for Career Development and Training is optional, supervisors are expected to ask employees if they have career development or training interests.

We recognize that a method of documenting development plans should be one tool available to manage employees with deficiencies in their job performance and those that are interested in developing knowledge, skills, abilities, education and training to obtain or retain competencies. We agree with the current policy application.

- c. Auditor's Findings: **The agency did not adequately document corrective action plans.**

Auditor's Recommendation: "State agencies should ensure that corrective action plans are properly completed for all employees who fail to meet performance expectations."

Agency Response: We agree that the content of some of the corrective action plans reviewed during the audit period may not have contained every element. North Carolina Department of Correction policy requires that the corrective action plans identify the performance/behavior deficiency; corrective action to be implemented; time frame for improvement; and date of the follow-up discussion. In Section D of the Employee Action Plan, supervisors/managers may identify consequences for failing to improve.

We recognize the importance of completing the corrective action plans to address poor performance and this is emphasized in agency policy and training. Automated tools currently exist to perform a detailed review of corrective action plans. Completion of The Employee Action Plan is emphasized in training.

Agency Recommendation: The Department of Correction currently has policies that address the requirements for corrective action as well as the tool (i.e. the Employee Action Plan Form) for supervisors and managers to document the corrective action plan. The web-based tracking program shall increase the department's ability to better track and monitor the corrective action plans that are implemented. Therefore, as already recommended, the department expects to expand the use of this web-based tracking program to all work locations. Individual work units will routinely use this information to monitor completion and compliance with the Performance Management Program.

The Honorable Beth A. Wood, State Auditor
Performance Management System Audit Report Response
Page Five

I appreciate the opportunity to provide comments regarding the audit and thank you and your staff for your recommendations. I am confident that our agency has and continues to work diligently to create efficiencies in administering an effective Performance Management Program. We provided copies of the Agency Trend Analysis Tool and written procedures to the State Auditor's Office as well as a sample of the web-based application tracking tool. The on-going work and the various work flows that have been created directly address many of your findings and recommendations. The extensive development of the web-based tool developed by our Performance Management staff and Management Information staff since 2009 has already yielded improvements during the pilot that will be implemented agency-wide.

Sincerely,


Alvin W. Keller, Jr.

AWKJr/VR/KR/BD/jbk

Attachments

cc: Jennie Lancaster
James French
Tracy Little
Frank Rogers
Lavee Hamer
Pamela Walker
Valerie Robinson
Kathy Reitzel
Beth Dail

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