



STATE OF NORTH CAROLINA

STATE BOARD OF EXAMINERS OF PLUMBING, HEATING, AND FIRE SPRINKLER CONTRACTORS

FINANCIAL RELATED AUDIT

JUNE 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

**STATE BOARD OF EXAMINERS OF PLUMBING, HEATING,
AND FIRE SPRINKLER CONTRACTORS**

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WILLIAM H. EUBANKS, BOARD CHAIRMAN

ADMINISTRATIVE OFFICER

DALE DAWSON, EXECUTIVE DIRECTOR



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AUDITOR'S TRANSMITTAL

June 6, 2013

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors
Dale Dawson, Executive Director

This report presents the results of our financial related audit at the State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The results of our audit disclosed a deficiency in internal control that is considered reportable under *Government Auditing Standards*. This item is described in the *Audit Findings and Recommendations* section of this report. The Board's response to the finding is included in the *Agency Response to Findings* section.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

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

Beth A. Wood, CPA
State Auditor

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BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors (Board). There were no special circumstances that caused us to conduct the audit, but rather it was performed in accordance with Chapter 93B of the *North Carolina General Statutes*, which states that the State Auditor shall audit occupational licensing boards occasionally to ensure their proper operation.

The Legislature established the Board in 1931. The purpose of the Board is to 1) protect the public health, safety and welfare by prescribing the standard of competence, experience and efficiency of applicants for license by examination; 2) enforce the statutory requirement of General Statutes 87, Article 2 and Board Rules set forth in 21 NCAC 50; and 3) hold open hearings for the benefit of licensee and the general public.

The Board currently oversees more than 11,700 licensees and 2,000 sublicenses.

AUDIT SCOPE AND OBJECTIVES

The general objective of this financial related audit was to identify improvements needed in internal control over selected fiscal matters. Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Our audit scope covered the period January 1, 2012 through December 31, 2012. During our audit, we considered internal controls related to the following transaction types and specific objectives:

Legal Expenses – The Board’s attorney provides legal services on many matters, including court cases, administrative hearings, appeals to the Court of Appeals, legislative matters, and ethics training. We examined internal control designed to ensure that procurement decisions for legal services were prudent. For the year ended December 31, 2012, the Board reported approximately \$323,000 in legal expenses.

Renewal/License and Application Fee Revenue – The Board collects application and annual renewal fees for individuals, corporations, and partnerships. For the year ended December 31, 2012, the Board reported approximately \$1.8 million in application and annual renewal fees. We examined internal control designed to ensure that the Board’s collections of fees were as authorized by statutory authority and that revenues were properly recognized and accounted for by the Board.

Licensing Operations – The Board is responsible for determining that applicants meet the qualifications as described in *North Carolina General Statutes Chapter 87, Article 2 - Plumbing and Heating Contractors* and issuing certificates to those determined to be properly qualified. We examined internal control designed to ensure that the Board issued licenses to only qualified applicants.

Inspection and Complaint Resolution – We examined internal control designed to ensure that investigative complaints were completed in a timely manner and corrective action was taken for noted violations.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control over matters described in the *Audit Scope and Objectives* section of this report and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objectives. Specifically, we interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances, as considered necessary in the circumstances. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically. As a result, we were able to project our results to the population but not quantify the sampling risk.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

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

RESULTS AND CONCLUSIONS

The results of our audit disclosed a deficiency in internal control that is considered reportable under generally accepted government auditing standards. The item is described in the *Audit Findings and Recommendations* section of this report. Management's response is presented in the *Agency Response to Findings* section of this report. We did not audit the response, and accordingly, we express no opinion on it.

AUDIT FINDINGS AND RECOMMENDATIONS

NO COMPETITIVE PROCESS OR WRITTEN CONTRACT FOR LEGAL SERVICES

The North Carolina State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors (Board) procured legal services without undergoing a competitive bidding process. Additionally, the Board did not have a written contract with legal representatives specifying the terms of service and related compensation. As a result, the Board cannot provide reasonable assurance that it obtained legal services from the best-qualified law firm at the lowest cost, and without a contract, the Board cannot ensure its interest is protected. The Board paid approximately \$323,000 for legal services for the year ended December 31, 2012.

Legal Services Procured Without Competitive Process

The Board did not use a competitive bidding process to obtain legal services. The Board's attorney provides legal services on many matters including court cases, administrative hearings, appeals to the Court of Appeals, legislative matters, and ethics training. Prior to 2009, the Board used hourly billing to pay its law firm. In 2009, the Board decided to use a flat fee arrangement moving forward with its attorney, who has represented the Board since 1972.

Prudent procurement practices require the use of a competitive selection process to obtain high quality services at competitive prices. The National Association of State Procurement Officials states, "In a competitive market, the consumer, including the government purchaser, attains the highest quality commodities at the lowest possible prices or costs. Where vendors must compete, they cannot elevate prices and reduce quality without suffering a loss of customers."

In comparison to similar licensing boards in the state, the Board's legal expenses are substantially higher. The Board's legal expenses per licensee were almost twice the amount of similar licensing boards, but it did have more than three times the number of complaints that led to injunctions. Without soliciting competitive bids, the Board cannot provide reasonable assurance that it selected the best-qualified law firm at the lowest cost.

The Board decided not to competitively bid its legal services based on the belief that a long-term relationship was more effective than a low-bid method¹. The Board further explained that a low-bid method was not used because its legal work is not generic work, and is significant both in its breadth and extent. However, the Board did not provide any written justification to ensure the selection process was objective, fair, and transparent.

No Written Contract for Legal Services

The Board did not have a written contract or retainer agreement with its law firm. The Board told us that they had a flat fee arrangement with its law firm for the last three years and the annual rate was \$325,000. During the year, the Board made equal monthly payments of \$27,083.

¹ Contracts should be awarded to the most qualified vendor at the best price rather than automatically awarding to the low-bidder.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

The attorney submitted monthly invoices to the Board describing details of the cases that they had worked on during the month, including the number of hours spent on these cases. However, the number of hours spent was not included after the October 2012 invoice.

The National State Auditor Association's "*Best Practices in Contracting for Services*" states, "Contracts for the purchase of services must be formal written documents." Furthermore, contracts "should (1) protect the interests of the agency; (2) identify the responsibilities of the parties to the contract; (3) define what is to be delivered; and (4) document the mutual agreement, the substance, and parameters of what was agreed upon." Specifically, the contract should:

1. Clearly state and define the scope of work, contract terms, allowable renewals, and procedures for any changes.
2. Describe the methods of payment, payment schedules, and escalation factors, if applicable.
3. Include provisions for contract termination.
4. Include provisions for contract renegotiation and/or price escalations, if applicable.
5. Contain appropriate signatures, approvals, acknowledgements, or witnesses.

Without a written contract signed by both parties, the Board could not ensure whether the required services were adequately provided and whether safeguards were in place to limit its liability.

Recommendation: The Board should solicit competitive bids for its legal services and maintain adequate supporting documentation of the bidding process. In addition, the Board should enter into a written contract or retainer agreement, stipulating terms and conditions for the provision of the legal services.

AGENCY RESPONSE TO FINDINGS

BOARD MEMBERS

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T. G. PROFFIT Vice Chairman
P. K. SELBY Secretary/Treasurer
J. N. ROYAL
R. J. LONG
W. H. SULLIVAN III
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State Board of Examiners of Plumbing, Heating & Fire Sprinkler Contractors

Raleigh, N.C.

May 13, 2013

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

Re: State Board of Examiners of Plumbing, Heating and Fire Sprinkler Contractors
Financial Related Audit, May, 2013

Dear Ms. Wood:

We appreciated the opportunity to meet with you and your staff members on May 6, 2013 to discuss your audit findings and recommendations. We also appreciate the opportunity to respond to the audit findings and recommendations.

First, we are pleased that in the conduct of your financial related audit you found no issues or concerns with the handling of fees and revenues by the Board. Likewise, you found no areas of concern with handling of complaint processes by the Board. We certainly would have expected that to be the case in view of the annual “clean” audits we have obtained for many years from independent auditors.

The only two concerns you mentioned were the absence of a written contract or competitive process for selection of board counsel. On those matters we do wish to provide a more detailed response.

As to the contract, we have had an effective agreement between the Board and the law firm which provides counsel to the Board. For many years the law firm has made a proposal near the end of each year and that proposal has been reviewed

AGENCY RESPONSE TO FINDINGS (CONCLUDED)

before acceptance by the Board. Inasmuch as the proposal is an agreement for all legal services required, we have understood the parties are bound each to the other upon acceptance of the arrangement by the Board. Nevertheless, as of May 10, 2013, we have promptly documented the arrangement with an agreement executed by me at the direction of the Board since your visit. We believe that issue has been addressed. You also noted that the monthly statement from the law firm did not contain a summary sheet documenting the total hours for each month after October 2012. As was noted in our meeting this was a transitional result of a conversion to a different computer software by the law firm, a concern which has since been addressed.

The last area of concern you raised was a recommendation that the Board should bid out its legal services at periodic intervals using a competitive bidding procurement method. During our meeting we received a much better understanding of your recommendation that the bid process should be for legal services at our current level of experience as well with the current volume our board processes. With respect to legal costs, your audit findings indicate that the Board has addressed three times the number of complaints of similar Boards, but in comparison has only spent approximately twice the amount of comparable Boards. Beyond that the law firm has repeatedly modified its fee agreement to meet the desires of the Board and demonstrated its professionalism in holding legal costs flat during the most recent four years of recession. Your recommendation to the Board for securing legal services will be presented to the Board at this next business for their review and for them to decide their next action.

In conclusion, two of the three recommendations your office made have already been corrected. The third recommendation will be submitted to the board for consideration at their next business meeting.

Sincerely yours,



Dale L. Dawson
Executive Director

cc: William Eubanks

ORDERING INFORMATION

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