

**AUDIT REPORT
BY
THE MATERIALS MANAGEMENT OFFICE
OF
THE STATE BUDGET AND CONTROL BOARD
REGARDING
THE SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION'S
EXEMPTION FROM THE CONSOLIDATED PROCUREMENT CODE
UNDER SECTION 11-35-710(1)**

October 15, 2010

Audit conducted pursuant to Section 57-1-490(B)

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STATE TREASURER

RICHARD ECKSTROM, CPA
COMPTROLLER GENERAL



SC BUDGET AND CONTROL BOARD

THE DIVISION OF PROCUREMENT SERVICES
DELBERT H. SINGLETON, JR.
DIVISION DIRECTOR
(803) 734-2320

R. VOIGHT SHEALY
MATERIALS MANAGEMENT OFFICER
(803) 737-0600
FAX (803) 737-0639

HUGH K. LEATHERMAN, SR.
CHAIRMAN, SENATE FINANCE
COMMITTEE

DANIEL T. COOPER
CHAIRMAN, HOUSE WAYS AND MEANS
COMMITTEE

FRANK W. FUSCO
EXECUTIVE DIRECTOR

October 15, 2010

Delbert H. Singleton, Jr., Esq.
Assistant Executive Director
State Budget & Control Board
Wade Hampton Building, 6th Floor
Capitol Complex
Columbia, South Carolina 29201

Dear Mr. Singleton:

We have completed our audit of the South Carolina Department of Transportation as required by Section 57-1-490, which provides as follows:

Section 57-1-490 (B): The Materials Management Office of the State Budget and Control Board annually must audit the department's internal procurement operation to ensure that the department has acted properly with regard to the department's exemptions contained in Section 11-35-710. The audit must be performed in accordance with applicable state law, including, but not limited to, administrative penalties for violations found as a result of the audit. The results of the audit must be made available by October fifteenth to the Department of Transportation Commission, the Department of Transportation's chief internal auditor, the Governor, the chairmen of the Senate Finance and Transportation Committees, and the chairmen of the House of Representatives Ways and Means and Education and Public Works committees. The costs and expenses of the audit must be paid by the department out of its funds.

The South Carolina Department of Transportation's administration is responsible for establishing and maintaining a system of internal controls over procurement transactions. The objectives of such a system are to provide management with reasonable, but not absolute, assurance that the procurement process is conducted with integrity; that transactions are executed in accordance with the law and with management's authorization; and that transactions are recorded properly.

Because of inherent limitations in any system of internal controls, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the system of internal controls over procurement transactions, as well as our overall examination of procurement policies and procedures, were conducted with professional care. However, because of the nature of audit testing, they would not necessarily disclose all weaknesses in the system.

We performed the audit for the period July 1, 2009 through June 30, 2010. The current audit disclosed one procurement resulting in eleven contracts that did not meet the criteria of the exemption. No administrative penalties are warranted.

Sincerely,

A handwritten signature in black ink that reads "Voight Shealy". The signature is written in a cursive style with a large, prominent "V" at the beginning.

R. Voight Shealy
Materials Management Officer

EXECUTIVE SUMMARY

The South Carolina Department of Transportation (DOT) has a very broad exemption from the Consolidated Procurement Code (Procurement Code). In 2007, the General Assembly enacted a law that requires the Materials Management Office (MMO) to audit DOT annually with regard to DOT's application of this exemption. With this report, MMO has completed its third audit under this law.

DOT is exempt from the Procurement Code for all contracts for the construction, maintenance, and repair of bridges, highways, and roads; vehicle and road equipment maintenance and repair; and other emergency-type parts or equipment. As noted by the Attorney General, this exemption "is not artfully drafted and ...is susceptible to various interpretations." For 28 years prior to the last audit, MMO and DOT have often disagreed about the application of this exemption. However, our audit of DOT's procurements for the period of July 1, 2009 through June 30, 2010 reflects that DOT and MMO have made considerable progress in reaching agreement on which contracts qualify under the wording of this exemption.

As stated in our prior audit report dated October 15, 2009, unless the current law relating to this exemption is amended, we continue to recommend DOT process all non-exempt procurements in accordance with the Procurement Code; that DOT and MMO complete development of a mutual understanding of DOT's exemption; and that DOT continue to monitor its internal policies and procedures in order to provide staff with clear guidance regarding which procurements are subject to the Consolidated Procurement Code and which procurements are exempt.

INTRODUCTION

In 1979, the American Bar Association adopted the first model procurement law in the country, the ABA's Model Procurement Code for State and Local Government. On the forefront of procurement reform, the South Carolina General Assembly enacted a modified version of this model law in 1981, the South Carolina Consolidated Procurement Code, codified in the South Carolina Code of Laws at Title 11, Chapter 35. As the name suggests, this comprehensive statutory scheme consolidated all the various laws governing procurement by state government and applied them to almost every state-level executive or judicial agency. DOT is a notable exception. Since its initial enactment, the Consolidated Procurement Code has expressly exempted broad categories of DOT procurements from any aspect of the Consolidated Procurement Code. That exemption appears in Section 11-35-710 and has remained virtually unchanged since its initial enactment: The exemption states:

The following exemptions are granted from this chapter: (1) the construction, maintenance, and repair of bridges, highways, and roads; vehicle and road equipment maintenance and repair; and other emergency-type parts or equipment utilized by the Department of Transportation or the Department of Public Safety;

Twenty-five years after granting this exception, the General Assembly asked the South Carolina Legislative Audit Council to audit DOT's management of the Department's resources. The LAC performed that audit and issued its report in November 2006. The following legislative session, the General Assembly enacted a law requiring a more specific audit: an annual audit of DOT's use of its Procurement Code exemption. An excerpt from that law states:

The Materials Management Office of the State Budget and Control Board annually must audit the department's internal procurement operation to ensure that the department has acted properly with regard to the department's exemptions contained in Section 11-35-710. The audit must be performed in accordance with applicable state law, including, but not limited to, administrative penalties for violations found as a result of the audit. The results of the audit must be made available by October fifteenth to the Department of Transportation, the Department of Transportation's chief internal auditor, the Governor, the chairmen of the Senate Finance and Transportation Committees, and the chairmen of the House of Representatives Ways and Means and Education and Public works Committees. The cost and expenses of the audit must be paid by the department out of its funds.¹

¹ 2007 Act No. 114, Section 5 (codified in S.C. Code Ann. Section 57-1-490(B))

The Materials Management Office (MMO) of the State Budget and Control Board issues this report pursuant to that mandate.

BACKGROUND

Section 57-1-490 (B) requires that MMO audit DOT “to ensure that the department has acted properly with regard to the department’s exemptions contained in Section 11-35-710.” Such an audit must begin with an understanding of the exemption’s meaning. The exemption remains virtually unchanged since its initial enactment:

The following exemptions are granted from this chapter: (1) the construction, maintenance, and repair of bridges, highways, and roads; vehicle and road equipment maintenance and repair; and other emergency-type parts or equipment utilized by the Department of Transportation or the Department of Public Safety;

On its face, the statute grants a number of exemptions. The second and third exemptions—the one for vehicle and road equipment maintenance and the one for emergency-type parts and equipment have received relatively little attention. In large measure, the people involved have treated these exemptions as unambiguous. In contrast, the exemption for “the construction, maintenance, and repair of bridges, highways, and roads” has been the subject of much discussion.

Over time, the discussions have centered on the meaning of the various phrases in the first part of the statute. The Attorney General noted this exemption “is not artfully drafted and ...is susceptible to various interpretations.” For more than 28 years, MMO and DOT have often disagreed about the use of this exemption.

To understand the standard we used for evaluating DOT’s contracts, we refer to the audit report dated October 15, 2008², to determine the breadth of DOT’s exemption for construction, maintenance, and repair of bridges, highways, and roads. The report states in part:

CONSTRUCTION INCLUDES DESIGN

Section 11-35-710(1) provides DOT an exemption for "the construction, maintenance, and repair of bridges, highways, and roads". The exemption must be read in conjunction with the definitions provided by the Procurement Code. The following four definitions are relevant.

² The October 15, 2008, DOT Exemption Report is available on the web at: http://www.mmo.sc.gov/MMO/webfiles/MMO_audit/Audit%20Reports/DOT08.pdf. Our discussion of the definition of construction titled “CONSTRUCTION INCLUDES DESIGN” begins on page 14 of that report.

"Construction" means the process of building, altering, repairing, remodeling, improving, or demolishing a public infrastructure facility, including any public structure, public building, or other public improvements of any kind to real property. It does not include the routine operation, routine repair, or routine maintenance of an existing public infrastructure facility, including structures, buildings, or real property."³

"Services" means the furnishing of labor, time, or effort by a contractor not required to deliver a specific end product, other than reports which are merely incidental to required performance. This term includes consultant services other than architectural, engineering, land surveying, construction management, and related services. This term does not include employment agreements or services as defined in Section 11-35-310(1)(d).

"Architect-engineer and land surveying services" are those professional services associated with the practice of architecture, professional engineering, land surveying, landscape architecture, and interior design pertaining to construction, as defined by the laws of this State, as well as incidental services that members of these professions and those in their employ may logically or justifiably perform, including studies, investigations, surveys, evaluations, consultations, planning, programming conceptual designs, plans and specifications, cost estimates, inspections, shop drawing reviews, sample recommendations, preparation of operating and maintenance manuals, and other related services.

"Construction management services" are those professional services associated with a system in which the using agency directly contracts with a professional construction manager to provide that group of management activities required to plan, schedule, coordinate, and manage the design and construction plan of a state project in a manner that contributes to the control of time, cost, and quality of construction as specified in the construction management contract.

³ 11-35-310(7) In 2008, the definition of construction was amended. 2008 Act No. 174. Whether under the old or current definitions of construction, the audit exception taken in this report remains the same.

Read together, these definitions clearly distinguish construction services from non-construction services, both those related to construction and those not. Narrowly looking at these definitions, DOT's exemption does not extend to any non-construction services because the term construction does not include architectural and engineering, construction management, and land surveying services. However, for reasons stated in the October 15, 2008, audit report, MMO applies a broader definition of construction to DOT's exemption. MMO interprets that exemption to include construction related professional design services, as defined by law.

MMO and DOT agree with the standard used for evaluating whether DOT's contracts fit the exemption. Our audit of DOT's expenditures for the period of July 1, 2009 through June 30, 2010 reflects that DOT and MMO have made considerable progress in reaching agreement on which specific types of contracts qualify under this standard.

SCOPE

We conducted our review in accordance with Generally Accepted Auditing Standards as they apply to compliance audits. We conducted our on-site review from July 16 through August 18, 2010. We selected samples from the period July 1, 2009 through June 30, 2010, for compliance testing. We reviewed these samples and performed other audit procedures that we considered necessary to determine whether DOT acted properly with regard to the exemptions in 11-35-710(1). Our scope was limited to the application of the exemption and did not include a review of the procurement processes used. Primarily, our samples were limited to contracts awarded under DOT's exemption since our last audit. As an additional check, we selected a sample of expenditures from DOT's general ledger to verify the accuracy of the population of exempt contracts identified to us by DOT.

The scope of our audit included, but was not limited to, a review of the following:

1. Road Construction Contracts

We sampled seventy-eight contracts from a total population of four hundred three awarded since our last audit to determine if DOT acted properly with regard to the exemptions. We noted no exceptions.

2. Consultant and Design Related Professional Services

We sampled all sixteen contracts awarded to determine if DOT acted properly with regard to the exemptions. We noted no exceptions.

3. Procurements Identified as 'Exempt'

We reviewed eleven of twenty-two solicitations which the DOT Procurement Department identified internally as exempt. We noted no exceptions.

4. Procurements processed by the DOT Procurement Office

We sampled forty-three solicitations out of a total population of seventy-seven for vehicle and road equipment maintenance and repair and other emergency type parts or equipment utilized by DOT which were coded as exempt in the DOT Procurement System. We noted no exceptions.

5. Service Contracts

We tested all seven solicitations resulting in thirty contracts for non-professional services to determine if DOT acted properly with regard to the exemptions, with one exception noted.

6. Review of DOT Expenditure Files

We selected ninety-six expenditures exceeding \$2,500 each from a total population of 19,673 transactions. We traced each transaction identified as exempt back to listings provided to us by DOT to ensure exempt expenditures were properly identified and reported. We noted no exceptions.

RESULTS OF EXAMINATION

Our testing of DOT's transactions made through the exemptions in 11-35-710(1) of the South Carolina Consolidated Procurement Code resulted in one procurement that did not fit within the exemptions. The procurement resulted in eleven separate contracts.

<u>Solicitation</u>	<u>Scope of Work</u>	<u>Award Date</u>	<u>Evaluated Amount for Each Contract</u>
SB10137	Fixed Price Contracts for on-call Traffic Counts – Statewide	2/16/10	\$20,603 ⁴

The contracts for on-call, statewide traffic counts should not have been procured through the exemptions since they do not require performance by licensed engineering firms. The selected vendors are categorized as data collection and reporting entities. For the exemptions to apply, the contracts would have had to be procured through a licensed professional in the category defined in 11-35-2910(1) as “architect/engineer or land surveying service” as incidental to those services and tied to a specific construction project.

We were unable to relate traffic count studies to any of the exemptions for construction, maintenance and repair of bridges, highways and roads. As an example, the completion of a traffic count study may, in fact, conclude that no right of way construction or improvement is necessary at a selected intersection or roadway and therefore would not be tied to a specific construction project.

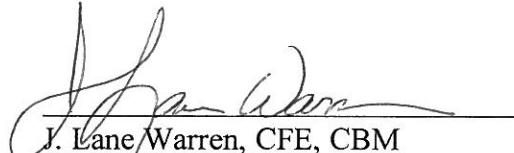
We recommend traffic count studies be procured in accordance to the competitive requirements of the South Carolina Consolidated Procurement Code.

⁴ The evaluated amount represents the maximum amount payable for one of each type of traffic count requested. It does not represent the maximum potential contract value. That information was not stated in the contract files.


CONCLUSION

Section 57-1-490 (B) of the South Carolina Code of Laws requires the Materials Management Office of the State Budget and Control Board to annually audit the South Carolina Department of Transportation's internal procurement operation to ensure that the department has acted properly with regard to its exemptions contained in Section 11-35-710. The audit must be performed in accordance with applicable state law, including, but not limited to, administrative penalties for violations found as a result of the audit. The results of the audit must be made available by October fifteenth to the Department of Transportation Commission, the Department of Transportation's chief internal auditor, the Governor, the chairmen of the Senate Finance and Transportation Committees, and the chairmen of the House of Representatives Ways and Means and Education and Public Works committees.

Our audit found DOT has acted properly with regard to its exemptions contained in Section 11-35-710 in all material respects. Audit results reflect the cooperative efforts between MMO and DOT in the development of a mutual understanding of DOT's exemptions. No administrative penalties are warranted.



J. Lane Warren, CFE, CBM
Audit Manager



Robert J. Aycock, IV, CPM, Manager
Audit and Certification



South Carolina
Department of Transportation

955 Park Street, Room 101
Columbia, South Carolina 29201

Director of Procurement
Michael A. Burk, CPPO
(803) 737-1481 ♦ Fax (803) 737-2046

September 14, 2010

Mr. Robert J. Aycock, IV
Manager, Audit and Certification
Materials Management Office
1201 Main Street, Suite 600
Columbia, South Carolina 29201

Re: Procurement Audit required by Section 57-1-490 (B)

Dear Mr. Aycock:

We are in receipt of the draft report from the 2010 exemption audit conducted in compliance with Section 57-1-490 (B) that was recently concluded by your able and capable staff. We appreciate the consideration displayed and the professional manner in which Lane, Mac, and Chris conducted the audit.

We concur with the findings of the audit. The direction offered is very clear and we waive any exit conference.

Thank you for your guidance and assistance with the audit.

Sincerely

Michael A. Burk, CPPO
Director of Procurement

MAB:mab

cc: Angela Feaster, Deputy Secretary for Finance and Administration
Michael Covington, Director of Administration