

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

October 10, 2013

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

W. BRIAN WHITE
CHAIRMAN, HOUSE WAYS AND MEANS
COMMITTEE

MARCIA S. ADAMS
EXECUTIVE DIRECTOR

October 10, 2013

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:

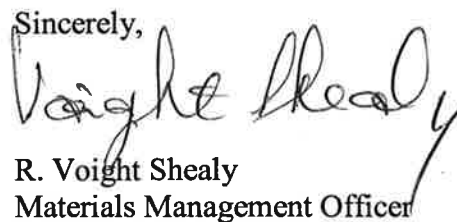
We have completed our audit of the South Carolina Department of Transportation exemptions from the South Carolina Consolidated Procurement Code as required by Section 57-1-490. The South Carolina Department of Transportation's administration is responsible for establishing and maintaining a system of 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, 2012 through June 30, 2013. No exceptions were identified during the current audit within the scope of our review. No administrative penalties are warranted.

Sincerely,

A handwritten signature in black ink that reads "R. Voight Shealy". The signature is written in a cursive style with a long, sweeping tail on the letter "y".

R. Voight Shealy
Materials Management Officer

INTRODUCTION

Since its initial enactment, the South Carolina Consolidated Procurement Code has expressly exempted broad categories of procurements of the South Carolina Department of Transportation, hereinafter referred to as DOT, from all aspects of the Procurement Code. Those exemptions appear in Section 11-35-710 and have remained virtually unchanged since its initial enactment: The exemptions state:

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 these exemptions, the General Assembly asked the South Carolina Legislative Audit Council (LAC) to audit DOT's management of its resources. The LAC performed that audit and issued its report in November 2006. The following legislative session, the General Assembly enacted Section 57-1-490, a law requiring a more specific audit, an annual audit of DOT's use of its Procurement Code exemptions. 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

This report represents the sixth annual audit under this law by the Materials Management Office.

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

BACKGROUND

Section 11-35-710(1) provides DOT the following exemptions from all aspects of the procurement requirements of Title 11, Chapter 35:

(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;

Section 57-1-490(B) requires that the Materials Management Office (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 exemptions' meaning.

The exemptions have remained virtually unchanged since its initial enactment. On its face, the statute contains a number of exemptions. The second and third exemptions -- the one for equipment maintenance and the one for emergency-type parts and equipment -- have received relatively little discussion over the years. 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. Of primary concern is the meaning of the phrase "construction, maintenance, and repair of bridges, highways, and roads," and what each word encompasses.

To understand the standard we apply for evaluating DOT's contracts under the exemptions, we refer to the first DOT exemption audit report dated October 15, 2008². As noted, the second and third exemptions for equipment maintenance and for emergency-type parts and equipment have been treated as unambiguous and need no further explanation. The breadth of DOT's exemption for construction, maintenance, and repair of bridges, highways, and roads however, needs further discussion.

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.

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, one might conclude DOT's exemption for construction does not extend to any construction related professional services because the term construction does not include architectural and engineering, construction management, and land surveying services. However, for reasons stated at length in the October 15, 2008 audit report, MMO applies a broader definition of construction to DOT's exemption. MMO concluded the exemption includes construction related professional design services, as defined by law. Further, the exemption applies to contractual services for maintenance and repair of bridges, highways, and roads. However, the exemption does not apply to materials and supplies used by in-house personnel for such activities.

³ 11-35-310(7) In 2008, the definition of construction was amended. 2008 Act No. 174.

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 August 19 through August 28, 2013. We selected samples from the period July 1, 2012 through June 30, 2013, 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 exemptions and did not include a review of the procurement processes used. Most of our samples were limited to contracts awarded under DOT's exemptions since our last audit as follows:

1. Road Construction Contracts

We sampled thirty-four out of two hundred and seventy-nine contracts, or 12%, of road construction contracts 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 five out of five contracts, or 100% of consultant and design related professional services contracts awarded since our last audit to determine if DOT acted properly with regard to the exemptions. We noted no exceptions.

3. Review of Non-Professional Service Contracts

We sampled eight out of eighty-two or 10%, non-professional service contracts awarded since our last audit relating to vehicle and road equipment maintenance and repair, and other emergency-type parts or equipment, and non-professional services provided within the right-of-way. We noted no exceptions.

4. Review of DOT Expenditure Files

We selected a statistical sample of expenditures from the general population of 50,160 transactions using a confidence level of 95% with a standard error of 5% resulting in a sample size of ninety-six expenditures each exceeding \$2,500. From this sample, we traced each transaction we identified as exempt back to the exempt listings provided to us by DOT to ensure exempt expenditures were properly identified and reported to us. We noted no exceptions.

5. Review of DOT Capital Improvements

We sampled thirteen out of one hundred and twenty-four, or approximately 10%, of the capital improvement projects awarded to determine if DOT acted properly with regard to the exemptions. We noted no exceptions.

RESULTS OF EXAMINATION


DOT has very broad exemptions from the Procurement Code. In 2007, the General Assembly enacted a law that requires MMO to audit DOT annually with regard to DOT's application of these exemptions. With this report, MMO has completed its sixth annual audit under this law.


DOT exemptions from the Procurement Code apply to procurements for construction, maintenance, and repair of bridges, highways, and roads; vehicle and road equipment maintenance and repair; and other emergency-type parts or equipment. Our testing of DOT's internal procurement operation of procurement transactions for the period July 1, 2012 through June 30, 2013 to ensure that DOT acted properly with regard to its exemptions resulted in no exceptions being identified.

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 acted properly with regard to its exemptions contained in Section 11-35-710 in all material respects. No administrative penalties are warranted.


J. Lane Warren, CFE, CBM
Audit Manager


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



South Carolina
Department of Transportation

September 25, 2013

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

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

Dear Mr. Aycock:

We are in receipt of the draft report from the 2013 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 your team conducted the audit.

We are pleased that no exceptions were noted and concur with the findings of the audit. We are committed to continuing to follow the able direction that has been offered and are looking forward to continued cooperation between the South Carolina Department of Transportation (SCDOT) and the Materials Management Office of the Budget and Control Board.

Thank you for your guidance and assistance with the audit.

Sincerely,

Sherry D. Barton
Chief Procurement Officer

SDB: clb

ec: Lane Warren, Audit Manager, Materials and Management Office
Christy A. Hall, SCDOT Deputy Secretary for Finance and Administration