

**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, 2009

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

TABLE OF CONTENTS

	<u>PAGE</u>
Transmittal Letter	1
Executive Summary.....	3
Introduction.....	4
Background.....	6
Scope.....	9
Results of Examination.....	11
Follow-up on Recommendations from the last Audit.....	12
Conclusion	16
SCDOT’s Response to Audit Report.....	17

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October 15, 2009

**Delbert H. Singleton, Jr., Esq.
Assistant Executive Director
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Wade Hampton Building, 6th Floor
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Columbia, South Carolina 29201**

Dear Mr. Singleton:

We have completed our audit of the SC 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.

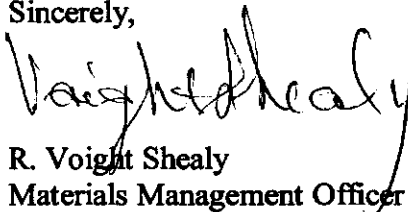
Because of inherent limitations in any system of internal controls, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree 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, 2008 through June 30, 2009. In addition, we performed a follow-up review of our recommendations made from our prior audit dated October 15, 2008.

The current audit did disclose one procurement that did not meet the criteria of the exemption. 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 large, prominent "V" and "S".

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. MMO has completed its second 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 27 years prior to the last audit, MMO and DOT have often disagreed about the application of this exemption. Since the last audit, MMO and DOT have conducted numerous meetings regarding this issue largely reaching an agreement on the exemption's meaning. Discussions are ongoing regarding the exemption's application to specific contracts. Our recent audit of DOT's procurements for the period of July 1, 2008 through June 30, 2009 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, 2008, 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

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

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

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 previous audit report dated October 15, 2008, 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.

"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."²

"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.

² 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 previous audit report, MMO applies the 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, 2008 through June 30, 2009 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 August 14 through September 16, 2009. We selected samples from the period July 1, 2008 through June 30, 2009 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 exemption 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-five contracts from a total population of three hundred twenty-seven awarded since our last audit to determine if DOT acted properly with regard to the exemption. We noted no exceptions.

2. Consultant and Design Related Professional Services

We sampled thirty-three contracts out of a total population of fifty awarded to determine if DOT acted properly with regard to the exemption with one exception noted.

3. Procurements not coded as 'Exempt'

We reviewed all eight solicitations which DOT identified as exempt, but were not coded as such in the DOT Procurement System. We noted no exceptions.

4. Procurements processed by the DOT Procurement Office

We sampled forty-two solicitations out of a total population of seventy-five 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 ten solicitations resulting in seventy-three contracts for non-professional services to determine if DOT acted properly with regard to the exemption. We noted no exceptions.

6. Review of DOT Expenditure Files

We selected ninety-six expenditures exceeding \$2,500 each from a total population of 17,786 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 exemption in 11-35-710(1) of the South Carolina Consolidated Procurement Code resulted in one contract that did not fit within the exemption. DOT procured this contract through a professional service qualifications based selection process.

<u>Project</u>	<u>Scope of Work</u>	<u>Contract Execution Date</u>	<u>Amount</u>
S-62-08	Photogrammetrics I-126, I-26, I-20	5/27/09	\$405,000

The contract for photogrammetric services (aerial photography) should not have been procured through the exemption since it was not with any of the licensed professionals noted in 11-35-2910 to provide design services for construction, nor was it incidental to such a contract. DOT directly hired an aerial photography firm to provide aerial mapping services using a qualifications based selection process through the exemption, but should have followed the competitive requirements of the Procurement Code.

We recommend photogrammetric service be procured in accordance to the competitive requirements of the South Carolina Consolidated Procurement Code.

FOLLOW-UP ON RECOMMENDATIONS FROM THE LAST AUDIT

We performed a follow-up on the recommendations made in our last exemption audit report for the period June 27, 2007 through June 30, 2008 to determine the status of each. We made recommendations in two categories, specific and general.

Specific Recommendations to SCDOT

Recommendation #1

MMO recommends that procurements of supplies be processed in accordance with the Consolidated Procurement Code.

Status: *MMO found no exceptions to our recommendation.*

Recommendation #2

MMO recommends that the scope of exempt contracts be limited to work within the scope of DOT's exemption.

Status: *MMO found no exceptions to our recommendation.*

Recommendation #3

MMO recommends that procurements of non-exempt consultant and design related services be processed in accordance with the Consolidated Procurement Code.

Status: *MMO found one exception to this recommendation. Our audit results reveal material compliance with this recommendation.*

Recommendation #4

MMO recommends that DOT revise its internal policies and procedures. Generally, the

Department's policies and procedures should provide staff with clear guidance regarding which procurements are subject to the Consolidated Procurement Code and which procurements are exempt. We have not been able to identify such guidance in the Department's policies and procedures. For example, we have not identified any guidance regarding where the distinction has been made regarding consultant and design related professional services that are exempt versus those that are subject to the Procurement Code. MMO therefore recommends the Department revise its internal policies and procedures to resolve this deficiency.

Status: *MMO and DOT have conducted numerous meetings largely reaching an agreement on the exemption's meaning. Discussions are ongoing regarding the exemption's application to specific contracts.*

Recommendation #5

MMO recommends that DOT and MMO cooperate to develop a mutual understanding of DOT's exemption. In doing so, we recommend applying the exemption exactly as written, using ordinary meanings for any words not defined by the Consolidated Procurement Code, rather than relying on historical agreements between the agencies.

Status: *MMO and DOT have conducted numerous meetings largely reaching an agreement on the exemption's meaning. Discussions are ongoing regarding the exemption's application to specific contracts. Our recent audit of DOT's procurements for the period of July 1, 2008 through June 30, 2009 reflects that DOT and MMO have made considerable progress in reaching agreement on which contracts qualify under the wording of this exemption.*

General Recommendations

These recommendations were interrelated and were intended to be adopted together as a coordinated approach to addressing the challenges of the exemption.

General Assembly

Recommendation #1

Consider repealing DOT's existing exemption, as provided by Section 11-35-710(1), to make the Consolidated Procurement Code applicable to all DOT procurements.

Status: *The exemption has not been repealed.*

Recommendation #2

Consider amending Section 11-35-40(3), as shown below, to add clarity to a statute that makes state procurement rules yield to mandatory federal rules:

Compliance with Federal Requirements. Where a procurement involves the expenditure of federal assistance, grants, or contract funds, the government body shall also shall comply with such federal law and laws (including authorized regulations) as are mandatorily applicable and which are not presently reflected in the this code. Notwithstanding, where federal assistance, grant, or contract funds are used in a procurement by a governmental body as defined in Section 11-35-310(18), this code, including any requirements that are more restrictive than federal requirements shall, must be followed, except to the extent such action would render the government body ineligible to receive federal funds whose receipt is conditioned on compliance with mandatorily applicable federal laws. In those circumstances, the solicitation must identify and explain the impact of such federal laws on the procurement process, including any required deviation from this code.

At a minimum, MMO recommends that the General Assembly consider clarifying DOT's exemption. For 27 years, debate over the application of this exemption has consumed countless hours of staff time, both at DOT, MMO, and the Attorney General's Office. If the General Assembly chooses only to clarify the exemption, MMO recommends that DOT and MMO cooperate to jointly recommend appropriate clarifying language.

Status: *The General Assembly amended Section 11-35-40(3) in 2009 to reflect recommended changes to this subsection.*

Budget and Control Board

Recommendation #3

Under Section 11-35-1210, consider granting DOT unlimited certification in those areas where DOT currently has unlimited authority under its exemption.

Status: *Until the exemption is repealed, no action is required by the Budget and Control Board to grant DOT unlimited certification in those areas where DOT currently has unlimited authority under its exemption.*

Chief Procurement Officers

Recommendation #4

Under Section 11-35-840, consider delegating appropriate authority to SCDOT e.g., authority to administratively review contract disputes under Sections 11-35-4230 and 11-35-4320 regarding the construction and design of roads and bridges.

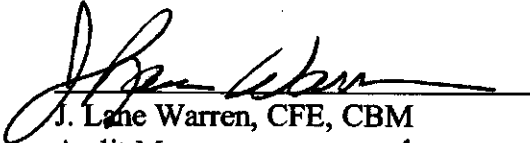
Status: *Until the exemption is repealed, no action is required by the Chief Procurement Officers to grant DOT authority to administratively review contract disputes under Sections 11-35-4230 and 11-35-4320 regarding the construction and design of roads and bridges.*


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.

As stated in our prior audit report dated October 15, 2008, unless the current law relating to this exemption is changed, we continue to recommend the South Carolina Department of Transportation (DOT) process all non-exempt procurements in accordance with the Procurement Code; that DOT and MMO continue to develop 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. Audit results reflect the cooperative efforts between MMO and DOT in the development of a mutual understanding of DOT's exemption. Considerable progress has been made in reaching agreement on which contracts qualify under the wording of this exemption.

Our audit found DOT has 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, IV, CPM, Manager
Audit and Certification

**SOUTH CAROLINA DEPARTMENT OF TRANSPORTATION'S
RESPONSE TO AUDIT REPORT OF
MATERIALS MANAGEMENT OFFICE
October 15, 2009**

The South Carolina Department of Transportation (SCDOT) appreciates the opportunity to respond to the State Budget and Control Board's Materials Management Office ("MMO") Audit Report, dated October 15, 2009, regarding SCDOT's application of its exemption from the State Consolidated Procurement Code ("Procurement Code") found in S. C. Code Section 11-35-710(1).

The Audit Report identified one instance in which SCDOT has not complied with the exemption as it has been historically interpreted and applied pursuant to understandings between MMO and SCDOT. The exception has been noted and understood and SCDOT will take action to correct this in the future.

As a result of recommendations included in the October 15, 2008 report, during the past year, SCDOT and MMO have held several meetings in an effort to develop and document a mutual understanding of the application and interpretation of the exemption. This effort is continuing and the need for several meetings highlights the continued concerns by both parties about the ambiguity of the language in the Code.

When SCDOT's exemption was enacted, the South Carolina Department of Transportation ("SCDOT")³ had been procuring highway and bridge construction and maintenance contracts for almost 60 years pursuant to its own procurement procedures. These procedures were based on federal laws and regulations since most of the funding for highway construction came from federal funds, and still does. At the time the exemption was enacted, definitions were not included in the Code related to the exemption. In order to resolve the longstanding interpretation issues of the exemption language, we believe clarifying definitions need to be included in the Consolidated Procurement Code. We plan to coordinate with the Materials Management Office to define:

- "Construction of bridges, highways, and roads"
- "Maintenance of bridges, highways, and roads"
- "Repair of bridges, highways, and roads"

Ideally, these definitions will be codified within the Consolidated Procurement Code, but in the meantime, SCDOT will continue to work with MMO to develop and document a mutual understanding of the exemption for use by both parties.

SCDOT also agrees that its internal procedures should be revised to clarify which procurements are subject to the Procurement Code and which are exempt in order to provide staff with clear implementing guidance regarding whether procurements are subject to the Consolidated Procurement Code or are exempt.

³ At that time the agency was known as the "South Carolina Department of Highways and Public Transportation."