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State Budget and Control Board
PROCUREMENT SERVICES DIVISION

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R. VOIGHT SHEALY
MATERIALS MANAGEMENT OFFICER

July 19, 2004

Mr. Delbert H. Singleton Jr.
Director
Procurement Services Division
6th Floor-Wade Hampton Building
Columbia, South Carolina 29201

Dear Delbert:

I have attached the South Carolina Education Lottery Commission's procurement audit report and recommendations made by the Office of Audit and Certification. I concur and recommend the report be submitted as information to the Budget and Control Board.

Sincerely,

A handwritten signature in black ink, appearing to read "Voight Shealy".

R. Voight Shealy
Materials Management Officer

/jl

SOUTH CAROLINA EDUCATION LOTTERY COMMISSION

PROCUREMENT AUDIT REPORT

JANUARY 1, 2002 – JUNE 30, 2003

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NOTE: The Commission's responses to issues noted in this report have been inserted immediately following the items they refer to.

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R. VOIGHT SHEALY
MATERIALS MANAGEMENT OFFICER

March 11, 2004

Mr. R. Voight Shealy
Materials Management Officer
Office of Procurement Services
1201 Main Street, Suite 600
Columbia, South Carolina 29201

Dear Voight:

We have examined the procurement policies and procedures of the South Carolina Education Lottery Commission for the period January 1, 2002 through June 30, 2003. As part of our examination, we studied and evaluated the system of internal control over procurement transactions to the extent we considered necessary.

The evaluation was to establish a basis for reliance upon the system of internal control to assure adherence to the Consolidated Procurement Code, State regulations and Commission's procurement policy. Additionally, the evaluation was used in determining the nature, timing and extent of other auditing procedures necessary for developing an opinion on the adequacy, efficiency and effectiveness of the procurement system.

The administration of the South Carolina Education Lottery Commission is responsible for establishing and maintaining a system of internal control over procurement transactions. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance of the integrity of the

procurement process, that affected assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and are recorded properly.

Because of inherent limitations in any system of internal control, 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 control 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.

The examination did, however, disclose conditions enumerated in this report which we believe need correction or improvement.

Corrective action based on the recommendations described in these findings will in all material respects place the South Carolina Education Lottery Commission in compliance with the Consolidated Procurement Code and ensuing regulations.

Sincerely,



Larry G. Sorrell, Manager
Audit and Certification

INTRODUCTION

We conducted an examination of the internal procurement operating policies and procedures of the South Carolina Education Lottery Commission. Our on-site review was conducted August 26, 2003 through September 18, 2003 and was made under Section 11-35-1230(1) of the South Carolina Consolidated Procurement Code and Section 19-445.2020 of the accompanying regulations.

The examination was directed principally to determine whether, in all material respects, the procurement system's internal controls were adequate and the procurement procedures, as outlined in the Internal Procurement Operating Procedures Manual, were in compliance with the South Carolina Consolidated Procurement Code and its ensuing regulations.

During the audit process, the Budget and Control Board granted the South Carolina Lottery Commission the following procurement certification effective November 12, 2003.

<u>PROCUREMENT AREAS</u>	<u>CERTIFICATION LIMITS</u>
Goods and Services	\$ 25,000
Information Technology	\$ 25,000
Consultant Services	\$ 25,000

Our audit was performed primarily to determine if certification is warranted.

SCOPE

We conducted our examination in accordance with Generally Accepted Auditing Standards as they apply to compliance audits. Our examination encompassed a detailed analysis of the internal procurement operating procedures of the South Carolina Education Lottery Commission and its related policies and procedures manual to the extent we deemed necessary to formulate an opinion on the adequacy of the system to properly handle procurement transactions.

We selected samples for the period January 1, 2002 through June 30, 2003 of procurement transactions for compliance testing and performed other audit procedures that we considered necessary to formulate this opinion. Specifically, the scope of our audit included, but was not limited to, a review of the following:

- (1) All sole source, emergency and trade-in sale procurements for the period January 1, 2002 through June 30, 2003
- (2) Procurement transactions for the January 1, 2002 through June 30, 2003 as follows:
 - a) Sixty-five payments exceeding \$1,500 each
 - b) A block sample of all purchase orders issued for April, May and June of 2003
 - c) Two months of procurement card transactions
- (3) Minority Business Enterprise Plans and reports for the audit period
- (4) Information technology plan approval
- (5) Internal procurement procedures manual
- (6) Surplus property disposal procedures
- (7) File documentation and evidence of competition

RESULTS OF EXAMINATION

I. Unauthorized Procurements

A. Lottery Playstation Display Units

The Materials Management Office (MMO) issued contract 02-S4890-A8088 on behalf of the Commission for lottery playstations. The playstations are display units where people can get information about lottery games. They are located throughout South Carolina. The intent to award statement issued by MMO shows a unit price of \$167.32 each for 3,000 units that equates to a total value of \$501,960. The Commission issued a purchase order with a unit cost of \$171.92 for the 3,000 units for a total of \$515,760; an increase of \$13,800 over the contract issued by MMO. The increase of \$13,800 was not authorized by MMO thus resulting in an unauthorized procurement. The Commission must submit a ratification request to the Materials Management Officer in accordance to Regulation 19-445.2015 for the unauthorized change order.

The delivery requirement in the solicitation and award was to three locations. After the award by MMO, the Commission decided to have the vendor deliver the playstation units throughout South Carolina rather than to the three locations. However, the Commission did not contact MMO requesting an amendment to its contract thus creating another unauthorized change order. The playstation units were still being delivered during our audit. Due to our inquiry, the Commission instructed the vendor to terminate the deliveries throughout the state and begin the delivery in accordance to the delivery terms of the contract. The Commission identified \$26,924 in unauthorized delivery charges. The Commission must submit a ratification request to the Materials Management Officer in accordance to Regulation 19-445.2015 for the unauthorized change order

We recommend the Commission adhere to the contract requirements for awards issued by MMO. If changes are needed, MMO should be contacted for authorized change orders.

COMMISSION RESPONSE

We concur and will adhere to contract requirements for awards issued by MMO. This transaction was submitted for ratification on December 4, 2003 in compliance with Regulation 19-445.2015.

B. Promotional Items Artificially Divided

We discovered an artificially divided procurement for promotional pencils on purchase orders 261, 297 and 314. The total procurement was for 3,000 gross of pencils at \$3.33 per gross for a total of \$9,990.

<u>PO</u>	<u>PO Date</u>	<u>Invoice</u>	<u>Invoice Date</u>	<u>Invoice Quantity</u>	<u>Invoice Amount</u>
261	2/08/02	225004-1	2/13/02	1,000 gross	\$3,330
<u>PO</u>	<u>PO Date</u>	<u>Invoice</u>	<u>Invoice Date</u>	<u>Invoice Quantity</u>	<u>Invoice Amount</u>
297	3/07/02	225002-1	2/13/02	1,000 gross	3,330
314	3/22/02	225005-1	2/14/02	1,000 gross	<u>3,330</u>
				Total	<u>\$9,990</u>

The total of \$9,990 exceeded the Commission's procurement authority of \$5,000. The Commission issued purchase orders 297 and 314 subsequent to issuing purchase order 261 in an attempt maintain the appearance of three procurements of \$3,330 each. The Commission should have submitted a ratification request to the Materials Management Officer requesting ratification of the unauthorized procurement in accordance with Regulation 19-445.2015. Furthermore, the quote documents provided to us were not valid to support the competition on each of the three purchase orders.

We recommend the Commission comply with the procurement authorization limits as defined in the Code. We also recommend the Commission submit a ratification request to the Materials Management Officer in accordance with Regulation 19-445.2015.

COMMISSION RESPONSE

We concur and will combine procurements as required at Section 11-35-1550(1). This transaction was submitted for ratification on December 4, 2003 in compliance with Regulation 19-445.2015.

C. Advertising Contract

On check 5842 in the amount of \$5,150, the Commission procured an advertising sponsorship at a local event. The procurement file was not supported by a purchase order, evidence of competition, sole source or emergency justification, exempt or state contract reference. At that time the Commission's procurement authority was \$5,000. Since the procurement exceeded the Commission's procurement authority level, it was unauthorized. A

ratification request to the Materials Management Officer in accordance to Regulation 19-445.2015 will have to be made. Certain types of advertising contracts are exempt from the Code. However, the exemption is specific to advertising time or space in newspapers, radio or television. All other forms of advertising must be procured in accordance to the Procurement Code.

We recommend the Commission procure its advertising contracts in accordance with the Code.

COMMISSION RESPONSE

We concur and will procure contracts in accordance with the Code. This transaction was submitted for ratification on December 4, 2003 in compliance with Regulation 19-445.2015.

II. Contract with Advertising Consultant Needs Clarification

We reviewed several payments for compliance to a contract procured by the Materials Management Office (MMO) on behalf of the Commission. Some of the payments included reimbursements to the consultant for items that, in our opinion, were outside the scope of the contract and should have been procured in accordance to the Code. We discussed this issue with the Commission and MMO and it became obvious that confusion exists. Some of the confusion may be attributed to the wording or lack of wording in the consultant's contract. MMO did not intend for the consultant to make procurements subject to the Code on behalf of the Commission.

We recommend the Commission and MMO discuss the contract to clarify what purchases managed by the consultant are subject to the Code, which purchases are not subject to the Code, and prepare written documentation on the results of discussions.

COMMISSION RESPONSE

We concur and have initiated a related discussion on the contract with the State Procurement Office.

III. Sole Source Procurements Not Reported

A. Consultant Contracts for On-line Gaming

The Commission procured a consultant company for technical services for on-line gaming vendors as a sole source for \$144,500. At the time of the procurement, the Commission issued purchase order 263 for \$110,000 and reported the sole source with a value of \$110,000. Two amendments, one for \$7,500 and a second for \$50,000, were made to the contract. No additional amounts have been reported on this contract since the initial reporting of \$110,000. On January

10, 2003, the Commission declared another sole source contract for \$144,500 to this vendor but did not report the sole source procurement. Section 11-35-2440 of the Code requires governmental bodies to report sole source procurements each quarter to the Materials Management Officer. Additionally, Section I.5 of each contract allowed the consultant to seek reimbursements for expenses including travel, courier services, and other usual and customary items. The cumulative total of these paid expenses as of February 12, 2003 was \$63,017. The total included a category subcontract for \$6,297, an item that is not clearly identified as being allowable in the contract. The total values of the sole source contracts were underreported by at least \$299,517 as follows.

<u>Contract Period</u>	<u>Contract Value</u>	<u>Reported Amounts</u>	<u>Underreported Amounts</u>
10/19/01 - 12/31/02	\$202,000	\$110,000	\$ 92,000
01/10/03 - 12/31/03	144,500	0	144,500
Expenses	<u>0</u>	<u>0</u>	<u>63,017</u>
Totals	<u>\$346,500</u>	<u>\$110,000</u>	<u>\$ 299,517</u>

We recommend the Commission review its procedures to identify the weakness that resulted in the underreporting of \$299,517 in sole source procurements. Amended reports must be submitted to the MMO for the total value of each sole source procurement. Additionally, the Commission needs to determine if the reimbursement expense for subcontracts is allowable.

B. Motorcycle Instant Win Contract

The Commission issued a sole source contract with a total value of \$670,486 to manage and license the instant win game for motorcycles and accessories. The contract was effective December 20, 2002. The procurement was not reported as required by Section 11-35-2440 of the Code.

We recommend the Commission review its procedures to identify the weakness that resulted in the procurement not being reported. An amended report must be submitted to MMO for the sole source procurement.

COMMISSION RESPONSE

We concur and will report sole source procurements in accordance with Section 11-35-2440. We submitted amended reports on December 4, 2003 and March 29, 2004 in compliance with Section 11-35-2440. As to the category subcontract for \$6,297, the disbursement is authorized by Article 5 for the reimbursed expenses per agreement with the vendor dated January 15, 2003.

IV. Procurement Manual Not Updated

We reviewed the Commission's Procurement Policies and Procedures Manual in April of 2002 to determine if it complied with the Procurement Code and regulations and was adequate given the Commission's procurement authority. The Commission failed to update its manual. Since that time the Budget and Control Board increased the Commission's procurement authority which impacts our recommendations from April of 2002. Regulation 19-445.2005 requires governmental bodies to develop and forward their internal procurement procedures manual to the MMO for review.

We recommend the Commission update its manual and submit it to our office for review.

COMMISSION RESPONSE

We concur. We submitted the original edition of the manual to your office on September 20, 2001 in compliance with Regulation 19-445.2005. An amended edition, incorporating the changes subsequently recommended by your office, was submitted on June 29, 2004.

V. Minority Business Enterprise Reporting

We were unable to determine if the Commission submitted its Minority Business Enterprise (MBE) quarterly reports in a timely manner. The MBE quarterly report for the period October 1, 2002 through December 31, 2002 was not prepared. Section 11-35-5240 (2) requires MBE progress reports to be submitted not later than 10 days after the end of each quarter.

We recommend the Commission comply with the reporting requirements of the Code for MBE activity.

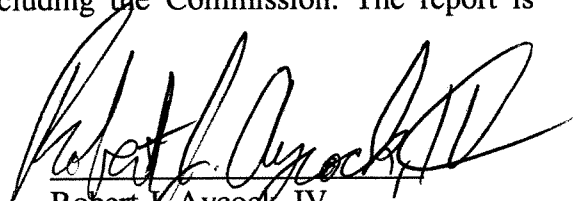
COMMISSION RESPONSE

We concur and will comply with reporting requirements for MBE activity. We submitted the referenced report to the Small and Minority Business Assistance Office on November 7, 2003 in compliance with Section 11-35-5240.

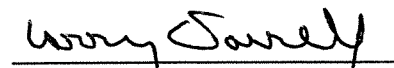
CONCLUSION

As enumerated in our transmittal letter, corrective action based on the recommendations, described in this report, we believe, will in all materials respects place the South Carolina Education Lottery Commission in compliance with the Consolidated Procurement Code and ensuing regulations.

As noted in the Introduction Section of this report, the Office of Audit and Certification was in the process of auditing the Commission on November 12, 2003 when the Budget and Control Board granted certification to fifty-eight agencies, including the Commission. The report is submitted as information only.



Robert J. Aycock, IV
Audit Manager



Larry G. Sorrell, Manager
Audit and Certification

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R. VOIGHT SHEALY
MATERIALS MANAGEMENT OFFICER

July 19, 2004

Mr. R. Voight Shealy
Materials Management Officer
Materials Management Office
1201 Main Street, Suite 600
Columbia, South Carolina 29201

Dear Voight:

We have reviewed the response from the South Carolina Education Lottery Commission to our audit report for the period of January 1, 2002 – June 30, 2003. Also we have followed the Commission's corrective action during and subsequent to our fieldwork. We are satisfied that the South Carolina Education Lottery Commission has corrected the problem areas and the internal controls over the procurement system are adequate.

Therefore, we recommend the report be submitted as information to the Budget and Control Board.

Sincerely,

A handwritten signature in cursive script that reads 'Larry G. Sorrell'.

Larry G. Sorrell, Manager
Audit and Certification

LGS/jl

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