

STATE OF NORTH CAROLINA

INVESTIGATIVE REPORT

**NORTH CAROLINA DEPARTMENT OF TRANSPORTATION
DIVISION OF HIGHWAYS, DIVISION 14**

SYLVA, NORTH CAROLINA

JUNE 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

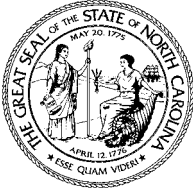
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AUDITOR'S TRANSMITTAL

The Honorable Beverly Perdue, Governor
Members of the North Carolina General Assembly
Eugene Conti, Jr., Secretary, North Carolina Department of Transportation

Ladies and Gentlemen:

Pursuant to North Carolina General Statute §147-64.6(c) (16), we have completed our investigation of allegations concerning the operations of the Department of Transportation, Division of Highways, Division 14. The results of our investigation, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with G.S. §147-64.6 (c) (12). We appreciate the cooperation received from the management and employees of the Department of Transportation during our investigation.

Respectfully submitted,

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

Beth A. Wood, CPA
State Auditor

June 29, 2012

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INTRODUCTION

The Office of State Auditor received allegations through the *State Auditor's Hotline* concerning the North Carolina Department of Transportation (DOT), Division of Highways, Division 14 Maintenance Department. The allegations included potential conflicts of interest involving state employees and contractors, preferential treatment afforded to certain contractors, inappropriate and excessive equipment purchases, and excessive overtime hours.

To conduct our investigation of these allegations, we performed the following procedures:

- Review of applicable DOT policies and procedures and North Carolina General Statutes related to contract and equipment procurement
- Interviews with various DOT officials and employees
- Interviews with various contractors and other sources
- Examination of relevant documents and records including equipment purchases made by DOT employees

This report presents the results of our investigation. The investigation was conducted pursuant to North Carolina General Statute § 147-64.6 (c) (16).

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EXECUTIVE SUMMARY

Our investigation resulted in the following findings:

- The District 2 Engineer authorized the use of fully operated rental equipment (rental equipment) for a road project and did not properly monitor the costs incurred. The project, originally funded at \$1.8 million, suffered a \$3.7 million cost overrun over an eight-month period. As a result, funds were moved from other projects to pay for the overrun. (Finding 1)
- The Haywood County Maintenance Department did not follow DOT policies and procedures for rental equipment contracts. Equipment was improperly added to purchase orders and contractor invoices were not properly approved prior to payment. The failure to follow procedures caused the over-utilization of rental equipment which increased the cost of a highway maintenance project. (Finding 2)
- The County Maintenance Engineer and two Transportation Workers in the Haywood County Maintenance Department purchased excessive quantities of tools and equipment. Because these items were purchased from a truck vendor that was not on state contract, DOT did not receive a 35% discount. In addition, the Maintenance Department could not locate several of the items purchased. These circumstances raised doubts about the propriety of these purchases. (Finding 3)
- The Haywood County Maintenance Engineer did not approve purchase card transactions as required by DOT policy. Instead, he directed the Office Assistant to perform this function. By delegating the approval authority, the County Maintenance Engineer reduced his ability to detect unauthorized and wasteful spending. (Finding 4)
- The Division 14 Contract Proposal Engineer was the sole coordinator for selecting rental equipment contracts. The predominant rental equipment contractor in Division 14 also employs the Engineer. This conflict of interest seriously diminished the integrity of the Division's contracting process. (Finding 5)
- Two employees in the Haywood County Maintenance Department were the only Timekeepers who routinely received overtime payments. Between January 1, 2008 and December 31, 2010, the two employees reported 26% more working hours than other Haywood County Maintenance Department employees. Their overtime payments totaled \$107,000, representing 46% of their total compensation. These employees said that no one questioned them about their hours worked, and they did what they were told. (Finding 6)
- A Transportation Worker and the Haywood County Maintenance Engineer are first cousins. Both employees worked in the Haywood County Maintenance Department overseen by the County Maintenance Engineer. As such, the County Maintenance Engineer approved the Transportation Worker's timesheets and purchases. This may lead to preferential treatment in the Maintenance Department. (Finding 7)

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ORGANIZATION OVERVIEW

North Carolina Department of Transportation

Division of Highways, Operations Unit

The North Carolina Department of Transportation (DOT), Division of Highways, Operations Unit is organized into 14 geographically defined “divisions.” (See map below) Within each of these divisions are three primary operational units:

- Maintenance – performs all maintenance functions of existing roads and bridges including brush clean-up and asphalt resurfacing
- Construction – performs construction of new roads and bridges
- Operations – performs a support role to the Maintenance and Construction units including equipment maintenance and repair functions as well as “roadside environmental” functions and traffic services



Each of the 14 divisions is headed by a division engineer who is responsible for all operations within the division. Reporting to the division engineer are engineers responsible for each of the operational units within the division.

Division 14

Division 14 is located in western North Carolina and is comprised of the following 10 counties: Henderson, Polk, Transylvania, Haywood, Jackson, Swain, Cherokee, Clay, Graham, and Macon. These counties are organized into three districts as follows:

- District 1 – Henderson, Polk, and Transylvania counties
- District 2 – Haywood, Jackson, and Swain counties
- District 3 – Cherokee, Clay, Graham, and Macon counties

The division office is located in Sylva while district offices are located in Mills River, Bryson City, and Andrews.

ORGANIZATION OVERVIEW (CONCLUDED)

Fully Operated Rental Equipment

DOT routinely supplements its own equipment with privately-owned equipment for emergency response or specialty equipment needs. For fully operated rental equipment (rental equipment), contractors provide both the equipment and the employees to operate the equipment.

Contractors submit a proposal listing all types of rental equipment their company can provide along with an associated hourly rate for each equipment type. When rental equipment is needed, DOT selects a given piece of equipment from the submitted proposals based on factors including lowest price, capacity, availability, and quality. Then, DOT issues an open-ended purchase order that remains in effect for one year. DOT personnel (timekeepers) oversee all operations. Timekeepers track and record the actual time each piece of equipment is used. Timekeepers provide contractors with timesheets that are reconciled at the job site to resolve any time differences. Then, the contractors use the reconciled timesheets to prepare invoices for payment at an approved hourly rate.

Purchase Card Program

Purchase cards enable organizations to make small purchases more quickly and efficiently by minimizing paperwork and processing time. Purchase cards can be used in a manner similar to credit cards. The use of purchase cards enables state agencies to make one large payment to the card provider rather than multiple small payments to many vendors. Purchase cards also offer an easy method to make emergency purchases for items such as repairs. Vendors receive payment from the card processor with minimal paperwork which encourages local small businesses to provide services to state agencies.

Purchase cards do not change the types of items allowed to be purchased but only streamline the payment method. With the increased efficiencies, there is an increased need to maintain control over who is authorized to possess and use purchase cards. The North Carolina Department of Administration has placed a transaction limit of \$2,500 on purchase cards. However, agencies may elect to establish more stringent limits that include amounts-per-time period, transactions-per-time period, or specific limits for each cardholder.

Each state agency that elects to utilize purchase cards must maintain control of its purchase card program. The purchasing and accounting functions must work together to ensure proper usage and compliance with state and agency policies.

FINDINGS AND RECOMMENDATIONS

1. FAILURE TO CONTROL RENTAL EQUIPMENT COSTS CONTRIBUTED TO A MULTIMILLION DOLLAR PROJECT OVERRUN.

The District 2 Engineer authorized the use of fully operated rental equipment (rental equipment) for a road project¹ and did not properly monitor the costs incurred. The project, originally funded at \$1.8 million, suffered a \$3.7 million cost overrun over an eight-month period. As a result, funds were moved from other projects to pay for the overrun.

According to a Division Maintenance Engineer memo, the District Engineer only became aware that the project was over-budget when it was brought to his attention by Division 14 management. According to the former Division Maintenance Engineer, the project costs should have been monitored continuously by the District Engineer so that a budget overrun would not have occurred. He further stated that, when the costs began to exceed the budget, work should have been halted. The District Engineer's lack of awareness of the extent of rental equipment costs contributed to the budget overrun.

According to Department of Transportation (DOT) records, the project expenditures increased to \$5.5 million as of March 2011. Rental equipment contracts totaled \$3.7 million which represented 65% of the total cost associated with the project.

District Engineer's Justification for Use of Rental Equipment

The District Engineer said that, because of the unique nature and difficulty of the work associated with this project, he decided to use rental equipment contracts rather than put the project out for bid. The District Engineer stated that, because of the many private driveways, low-hanging utility lines, and steep slopes that needed to be reduced, it would have been difficult to write a request for proposal and award a regular construction contract without requiring numerous amendments. Therefore, rental equipment contracts were used for clearing trees and brush on the slopes, hauling the debris off-site, and grinding the material into mulch.

In general, DOT prefers using bid contracts when utilizing private contractors for projects. In bid contracts, DOT inspectors oversee the work to ensure compliance with the contract specifications. The contractor is responsible for completing a specific project within a pre-determined time at an agreed-upon total project cost. Therefore, the total project costs are generally monitored and controlled more easily as compared to rental equipment contracts.

In contrast, rental equipment contracts are used to complement DOT employees to complete a project. Equipment (along with an operator) is rented on an hourly basis. Therefore, the rental equipment contractor has less incentive to complete the work timely or to control costs. Rental equipment contracts are dependent on DOT staff²

¹Wild Acres sub-division project in Maggie Valley, Haywood County

²Timekeepers/Inspectors who oversee and inspect the work performed by contractors

FINDINGS AND RECOMMENDATIONS (CONTINUED)

to monitor and supervise equipment use. If the equipment is not used in an efficient manner or excessive equipment is employed, project costs can quickly escalate.

Project Responsibility for Additions to Rental Equipment Contract Not Clear

The District Engineer and a Haywood County Engineering Technician (Technician) planned the project during an on-site meeting and decided the type of rental equipment and quantity the project needed. The District Engineer submitted a purchase order request to the Division Contract Proposal Engineer for approval.

The District Engineer and the Technician provided different accounts as to who had the responsibility to authorize additions to the purchase order. After the original purchase order was issued and work commenced, additional equipment was added to the purchase order.

Although the District Engineer was in charge of the project, he said that he delegated day-to-day project oversight authority to the Technician who had previous experience overseeing similar projects.

The Technician said that he did not have any decision-making ability for rental equipment additions and that he obtained prior approval from the District Engineer whenever additions were needed. However, the District Engineer said that he gave the Technician the authority to add any rental equipment needed and that he was asked to approve additions only on a few occasions.

Responsibility to Approve Invoices Improperly Delegated

The District Engineer admitted that he did not review and approve the rental equipment invoices as required by DOT policy. The District Engineer's Office Assistant stated that she took the rental equipment invoices received from the contractor and reconciled them to the daily equipment time logs submitted by the timekeepers. The Office Assistant used a signature stamp to indicate the District Engineer's approval.

RECOMMENDATION

Division 14 management should evaluate its policies and procedures related to the use of rental equipment contracts on road projects. Management should consider setting cost limits on any purchase orders for rental equipment contracts and require Division approval for use of any rental equipment contracts that exceed those limits. Division management should provide additional training for district and county engineers in project management to include the monitoring of project costs.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

2. FAILURE TO FOLLOW DOT'S CONTRACTING POLICIES FOR RENTAL EQUIPMENT UNNECESSARILY INCREASED THE COST OF HIGHWAY MAINTENANCE PROJECTS.

The Haywood County Maintenance Department did not follow DOT policies and procedures for rental equipment contracts. Equipment was improperly added to purchase orders and contractor invoices were not properly approved prior to payment. The failure to follow procedures caused the over-utilization of rental equipment which increased the cost of a highway maintenance project. (See Finding 1)

State highways are primarily maintained using DOT workers and state-owned equipment. However, DOT engineers may utilize private contractors to complement their efforts to complete a project. DOT may solicit a private contractor to take responsibility for an entire project or simply furnish needed equipment with an operator to supplement state resources.

Rental Equipment Contracting Process

When DOT field personnel determine that rental equipment is needed, they submit a request to the Contract Proposal Engineer who selects the contractor from a listing of submitted proposals based on factors including lowest price, capacity, availability, and quality. The Contract Proposal Engineer issues a purchase order which remains in effect for one year. The purchase order and the equipment lists can be updated with additional equipment and the hourly rates may be reduced at any time by the contractor.

According to the Contract Proposal Engineer, when additional rental equipment is needed, field personnel should contact her to ensure that the current hourly rate for any additional rental equipment is still the lowest rate on file. In addition, if a subsequent project is scheduled and the same equipment is needed, re-approval is required and the request must again go through the Contract Proposal Engineer to ensure the lowest hourly rate is obtained.

Purchase Order Process Not Followed

We reviewed several contract invoices and determined that invoices included rental equipment that was not on the original purchase order. In addition, we discovered that some of the added rental equipment was at a higher rate than available from other contractors for the same equipment.

Field personnel routinely authorized contractors to add rental equipment without going back to the Contract Proposal Engineer to update the purchase order. The Contract Proposal Engineer acknowledged that each district office had the ability to add rental equipment or use an existing purchase order without contacting her.

For example, the District 2 Engineer said that the timekeeper may add new equipment to the *Rental Equipment Time Supervisor's Daily Report*. According to the District Engineer's Office Assistant, when the contractor submits a payment invoice, she

FINDINGS AND RECOMMENDATIONS (CONTINUED)

reconciles it to the daily report and ensures the equipment is included on the purchase order's equipment list in the accounting system. If the equipment titles do not match, she contacts the project's timekeeper to ensure that the equipment was used. Then, she contacts the DOT Central Office Purchasing group to add the new equipment to the purchase order.

Invoice Approval Process Not Followed

The District 2 Engineer did not review and approve rental equipment invoices prior to payment in violation of DOT policy. The DOT Maintenance Operations Manual requires that the "Field Engineer will verify correctness of the invoice to the Rental Equipment Time Sheet and the purchase order and process these documents in the accounting system for approval."

The paid invoices reviewed were approved using the District Engineer's signature stamp. The Administrative Assistant and the District Engineer said that the stamp was used to "make things more efficient." The District Engineer said that he delegated responsibility to the Administrative Assistant to stamp his signature because "he was too busy to check and sign the large volume of invoices that came in each day."

The approval process exists to ensure payments are made only for authorized items and that the invoices are accurate. The process also enables the monitoring of the amount of rental equipment. The District Engineer admitted that using the signature stamp was not proper and discontinued its use in April 2011.

RECOMMENDATION

Division 14 management should consider revising its policy regarding purchase orders for rental equipment. Specifically, Division management should reduce the length of the contract term and create a separate purchase order for each project. In addition, management should consider establishing a contract amount threshold that requires Division approval before exceeding that limit.

Division 14 management should strengthen internal controls to ensure that field personnel notify the Division Contract Proposal Engineer for additions to an existing purchase order.

3. THREE DOT EMPLOYEES MADE EXCESSIVE PURCHASES, DISCOUNTS WERE LOST, AND ITEMS CANNOT BE LOCATED.

The County Maintenance Engineer and two Transportation Workers in the Haywood County Maintenance Department purchased excessive quantities of tools and equipment. Because these items were purchased from a truck vendor that was not on state contract, DOT did not receive a 35% discount. In addition, the Maintenance Department could not locate several of the items purchased. These circumstances raised doubts about the propriety of these purchases.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

Purchase Cards Used to Obtain Excessive Quantities of Tools and Equipment

The three Maintenance Department employees used DOT-issued purchase cards to obtain tools and equipment from a local tool truck vendor. Between July 2009 and December 2010, these employees spent \$31,426.70 (66%) of the \$47,354.33 Division 14 paid that vendor.

While the purchases included items that *could* be used in the employees' work, the quantity of individual items was excessive and unnecessary. Summarized below are a few examples along with explanations provided by the employees:

- **Fourteen flashlights**, costing between \$177 and \$184, for pipe box inspections and night paving work. Two flashlights were provided to the Division Environmental Engineer and the District Resident Engineer (both of whom have their own purchase cards) by the County Maintenance Engineer.
- **Eighteen cordless drills, wrenches, and screwdrivers**, ranging in price from \$159 to \$555, for pipe installation, mailbox repair, and general office maintenance needs.
- **Eight battery booster packs**, costing between \$219 and \$279, used to jump start vehicles because the "equipment shop prefers we don't use jumper cables."
- **Sixteen socket or socket/wrench sets**, costing between \$22 and \$430, for pipe installation, road sign, mailbox, fence repair, and general maintenance.
- **Seven infrared temperature guns**, costing between \$94 and \$104, for determining ground and asphalt temperature during paving and salt brine application.

The County Maintenance Engineer, one of the three employees making the purchases, said that the purchases were "extravagant" and that "they bought too much stuff." He also said that he bought tools for employees who are "afraid to purchase the items themselves." The County Maintenance Engineer also said, "...when people need something, I try to help them out...I'm kind-hearted and ...some people view me like Santa Claus." He added that he did not provide any items to non-DOT employees. He said all of the items were used for DOT-related purposes. He further said, "If I had it to do over again, I never would have allowed or made the number of purchases that we did."

The two Transportation Workers making the tool purchases stated that the County Maintenance Engineer approved all purchases and instructed them by saying, "if you need it, get it." Before these purchases, the two Transportation Workers said that they had few hand tools except for hammers and adjustable wrenches. The Transportation Workers said that, to obtain tools beyond these, "they had to scavenge from along the highways."

One of the Transportation Workers also said that the tools they bought "made the job easier." He further said that they might have gotten by without the tools, but it would not have been as efficient. This Transportation Worker also said that he did not think much about using the purchase cards because he was told that they could "use the cards for what was needed."

FINDINGS AND RECOMMENDATIONS (CONTINUED)

In late 2010, the District Engineer became aware of the large number of tool purchases by these three employees. In addition, DOT received an anonymous complaint letter naming the three employees. After the District Engineer consulted with Division 14 management, DOT revoked these employees' purchase cards as well as most of the purchase cards issued in Haywood County pending further review of card activity.

The District Engineer told us that, when he began to review the purchase card transactions, he was surprised to see the volume of purchases made by the three employees and that he immediately took his concerns to his supervisor, the Division Maintenance Engineer. The District Engineer said that he noticed that many of the tools appeared to be new and never used. Some of the tools were still in their original packaging.

Purchase Discounts Lost Because Tool Vendor Not on Statewide Contract

The Department of Administration, Division of Purchase and Contract negotiated a statewide contract with numerous vendors for the purchase of tools and related accessories at a discount to state agencies. This agreement is called a "term contract" and includes specific requirements to obtain the discounted pricing.

According to the statewide term contract, state agencies are entitled to receive a 35% discount if the tool purchases are made in accordance with the terms of the contract. The contract stipulates that all purchases should go through one of the service representatives identified in the contract. The term contract states, "Vendor tool trucks do not provide statewide term contract pricing and therefore our end-user must purchase items through a purchase order or local branch, if applicable."

Several District 2 employees said the Haywood County Maintenance Engineer told them to purchase tools from the tool truck vendor because DOT had a purchase order with the company that the truck vendor represented. We reviewed purchase card transactions for all Division 14 employees from July 2009 through December 2010 and calculated a total of \$47,354 of tool purchases made from this tool truck vendor. If the 35% discount had been applied to those purchases, DOT would have saved \$16,574.

The DOT Manager of Accounts Payable, whose office is responsible for managing the purchase card program, confirmed that the DOT Purchasing Department is responsible for monitoring the purchase cards to ensure compliance with term contracts and other purchasing procedures. The DOT Purchasing Card Policy and Procedures Manual states, "the Purchasing Department should review transactions to ensure compliance with State Contract Items and Internal Purchasing Procedures."

Some of the Tools Missing

The County Maintenance Engineer and the two Transportation Workers were unable to account for 17 items costing \$1,854.07 that they purchased from the tool truck vendor using their DOT-issued purchase cards. One employee said the missing items resulted

FINDINGS AND RECOMMENDATIONS (CONTINUED)

from a break-in that occurred at the Haywood County Maintenance facility the previous summer.

Shortly after this break-in, the County Maintenance Engineer completed an “Incident Report” and filed it with the Haywood County Sherriff’s Office and a “State Property Incident Report” filed with the State Bureau of Investigation. None of the items reported stolen included the missing tools purchased by the three employees.

One of the Transportation Workers said, “Folks worked for several days after the break-in to determine what was missing.” He said that he reported the missing tools to the County Maintenance Engineer. However, the County Maintenance Engineer said that he only spoke with two other employees to get information for the reports and was not told the tools were stolen.

After our inquiries and a full year after the break-in, the District Engineer filed a second “State Property Incident Report” with the State Bureau of Investigation. This second report included the 17 missing items that the three employees purchased. According to the report, “the theft of these items was not reported until an inventory was conducted in April 2011, and the items were not found on the premises.” Items reported missing on the second report included cordless screwdrivers, flashlights, pliers, a drill set, socket driver sets, cordless drills, and ratchets.

The District Engineer said that he was directed by his supervisor to submit the second SBI “Incident Report” after the items were deemed missing and that he simply took the employees’ statements and included them in the report. When asked about the claims the three employees made on the report, the District Engineer said that he doubted the accuracy of the explanation for the missing tools.

RECOMMENDATION

DOT management should establish controls to ensure that purchase card transactions are properly reviewed and approved to prevent excessive purchases. In addition, management should establish a process to determine and evaluate the proper type and quantity of tools necessary for each work crew.

DOT management should consider further action related to the missing tools and conflicting statements provided by employees. Management should contact the State Bureau of Investigation to report additional facts related to the break-in. The State Bureau of Investigation should consider any further action they may deem appropriate.

DOT management should consider the implementation of additional controls related to the maintenance of tool inventories used by transportation workers to ensure the proper accounting of tools.

DOT management should provide training to Division 14 personnel who are issued purchase cards. The training should include DOT policies related to the use of purchase cards and DOT policies related to statewide term contracts. Management should consider

FINDINGS AND RECOMMENDATIONS (CONTINUED)

seeking reimbursement for any overpayments for tools purchased from the local tool-truck vendor.

4. THE FAILURE TO FOLLOW THE APPROVAL PROCESS INCREASED THE RISK OF UNAUTHORIZED AND WASTEFUL PURCHASE CARD TRANSACTIONS.

The Haywood County Maintenance Engineer did not approve purchase card transactions as required by DOT policy. Instead, he directed the Office Assistant to perform this function. By delegating the approval authority, the County Maintenance Engineer reduced his ability to detect unauthorized and wasteful spending. (See Finding 3)

Office Assistant Used County Maintenance Engineer's Signature Stamp

The County Maintenance Engineer admitted that he did not review purchase card transactions for the Haywood County Maintenance Department. Instead, he directed his Office Assistant to approve all transactions with his signature stamp because he was often away from the office. The Office Assistant said that she thought this was acceptable because the District 2 Engineer had directed his staff to use a signature stamp in a similar manner. In addition, because the County Maintenance Engineer allowed the Office Assistant to use his signature stamp for all purchase card transactions, including his own, in effect, he approved his own purchases.

Policy Required Cardholder Manager to Approve Transactions

According to DOT policy, the person that authorizes the issuance of a purchase card is the Cardholder Manager for that card user and is responsible for approving all of that card's transactions. According to policy, the Cardholder Manager is responsible for approving (by signature) purchase card transactions and reviewing cardholder monthly statements.

In the Haywood County Maintenance Department, the County Maintenance Engineer is the Cardholder Manager except for his own card. The former Division Maintenance Engineer authorized the County Maintenance Engineer to receive a purchase card. Therefore, the former Division Maintenance Engineer became the Cardholder Manager (approving authority) for the County Maintenance Engineer.

The former Division Maintenance Engineer said that he never reviewed any of the County Maintenance Engineer's purchases. He believed the District Engineer, to whom the County Maintenance Engineer reported, had the responsibility of reviewing the transactions. However, the District Engineer said that he did not approve anyone's purchase card transactions.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

RECOMMENDATION

DOT management should provide training to staff regarding policies related to the review and approval of purchase card transactions. Management should ensure that the appropriate individuals review and approve purchase card transactions.

5. AN ENGINEER'S SECONDARY EMPLOYMENT CONFLICTED WITH DOT RESPONSIBILITIES.

The Division 14 Contract Proposal Engineer was the sole coordinator for selecting rental equipment contracts. The predominant rental equipment contractor in Division 14 also employs the Engineer. This conflict of interest seriously diminished the integrity of the Division's contracting process.

Contract Proposal Engineer's Primary DOT Responsibilities

Since June 2007, the Contract Proposal Engineer administered all bid contracts for Division 14. The Engineer said that she received contract proposal packages from the district engineers and ensured that they complied with DOT contract standards and specifications. She also said that she assisted the district engineers in writing special provisions or specifications as needed. The Engineer advertised the bids, received bid submittals, and coordinated the public bid opening.

In 2009, the Engineer also became the sole coordinator for selecting rental equipment contractors throughout Division 14. Prior to that time, each district engineer selected the contractors independently. According to DOT management, this change was implemented to ensure fair, consistent application of DOT policy related to rental equipment use.

Contract Proposal Engineer Also Worked for a Division 14 Contractor

Records provided by the Haywood County Erosion Control Department indicated that the Contract Proposal Engineer provided erosion control plans related to various projects for the owner of Caroline-A-Contracting, a local contractor that had ongoing work as a rental equipment contractor for Division 14 projects. Caroline-A-Contracting also submitted proposals for various bid contracts in Division 14.

The Engineer acknowledged that she performed work for the contractor. The secondary employment involved civil engineering consulting services for this private contractor who routinely submitted bids and was awarded contracts by Division 14. The Engineer's DOT responsibilities included development, solicitation, and awarding of those contracts.

Engineer Denied Conflict of Interest

The Contract Proposal Engineer submitted annual "Request for Secondary Employment" forms indicating that she engaged in secondary employment described as "Erosion control, water, septic and commercial site plans; environmental permits." Attached to each submitted form was an approval letter from the Division Engineer with stated

FINDINGS AND RECOMMENDATIONS (CONTINUED)

conditions as well as a request to inform DOT management if any potential conflicts of interest arise.

The Contract Proposal Engineer indicated on the form that there was no actual or perceived conflict of interest. She said she did not consider work for the contractor as a potential conflict of interest when completing the 2011 form because the contractor was not doing any contract work at the time. She said she did not include this information on any previous years' forms because she was "naïve."

The Division Engineer said that he was not aware of any business relationship between the Contract Proposal Engineer and the contractor and added that this relationship can certainly provide the perception of a conflict of interest. The Contract Proposal Engineer said that she did not inform the Division Engineer about her work for the contractor because "there is no conflict of interest" and that "to me, they are saying current conflict."

DOT Policy Required Employees to Report Potential Conflicts of Interest

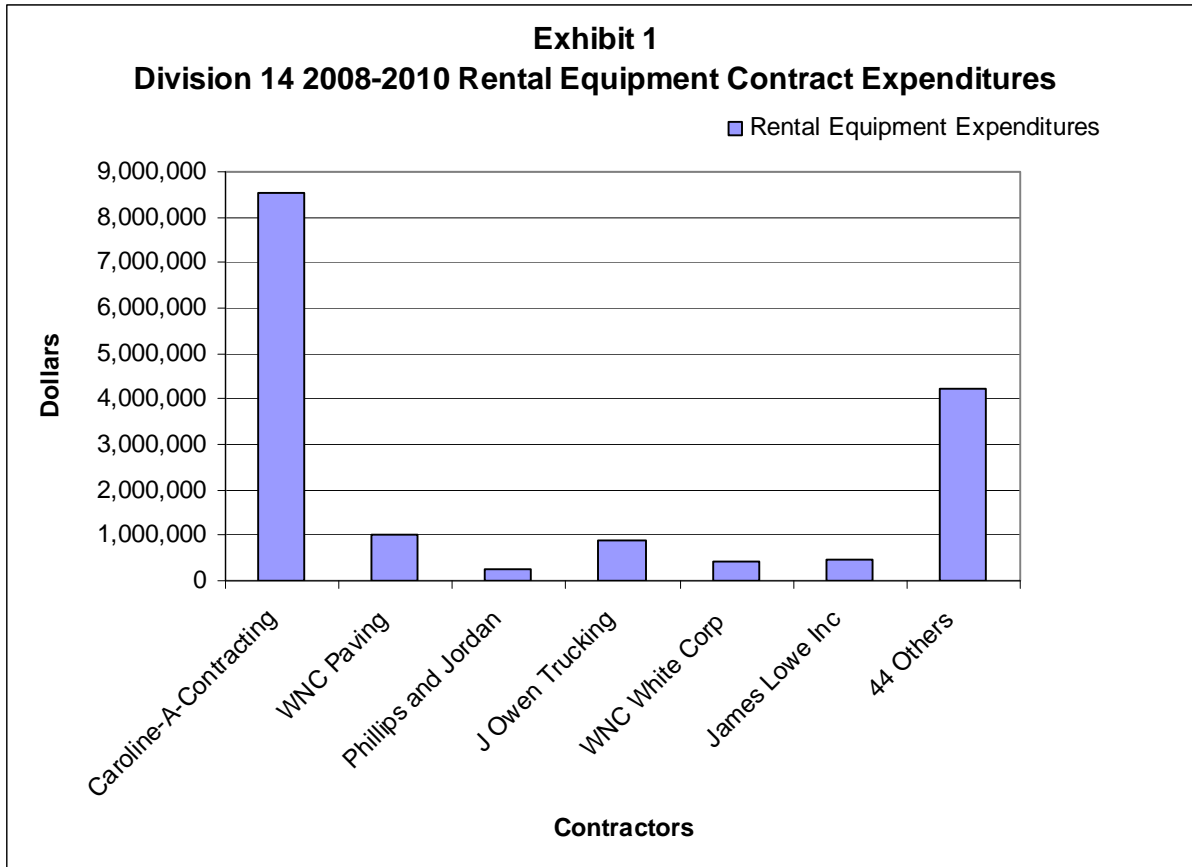
The purpose of the "Request for Secondary Employment" form was to provide DOT management the opportunity to evaluate any situation that might create an actual or perceived conflict in an employee's outside activities. It is management's responsibility, not the employee's, to make that evaluation. As such, the Contract Proposal Engineer should have fully disclosed her relationship with the contractor.

Integrity of Contracting Process Diminished

Our investigation did not reveal evidence to prove whether or not preference was given to Caroline-A-Contracting. However, the existence of an undisclosed business relationship between the owner of Caroline-A-Contracting and the individual responsible for selecting contractors created the perception that inappropriate preference was given.

Division 14's use of rental equipment contracts increased between 2008 and 2010 due to a number of factors such as the occurrence of a major rockslide, cuts in DOT budgets, and a significant road maintenance project that required the use of specialty equipment. As illustrated in Exhibit 1 below, Caroline-A-Contracting was the predominant rental equipment contractor used during this period.

FINDINGS AND RECOMMENDATIONS (CONTINUED)



The disproportionate utilization of Caroline-A-Contracting as a rental equipment contractor was attributable to various factors. Caroline-A-Contracting was one of the largest equipment suppliers in the area offering a variety of specialized equipment needed during this time including high output tub grinders and specialized tree cutting equipment used on steep slopes. In addition, Caroline-A-Contracting may have been able to meet DOT project needs more effectively by having equipment readily available.

RECOMMENDATION

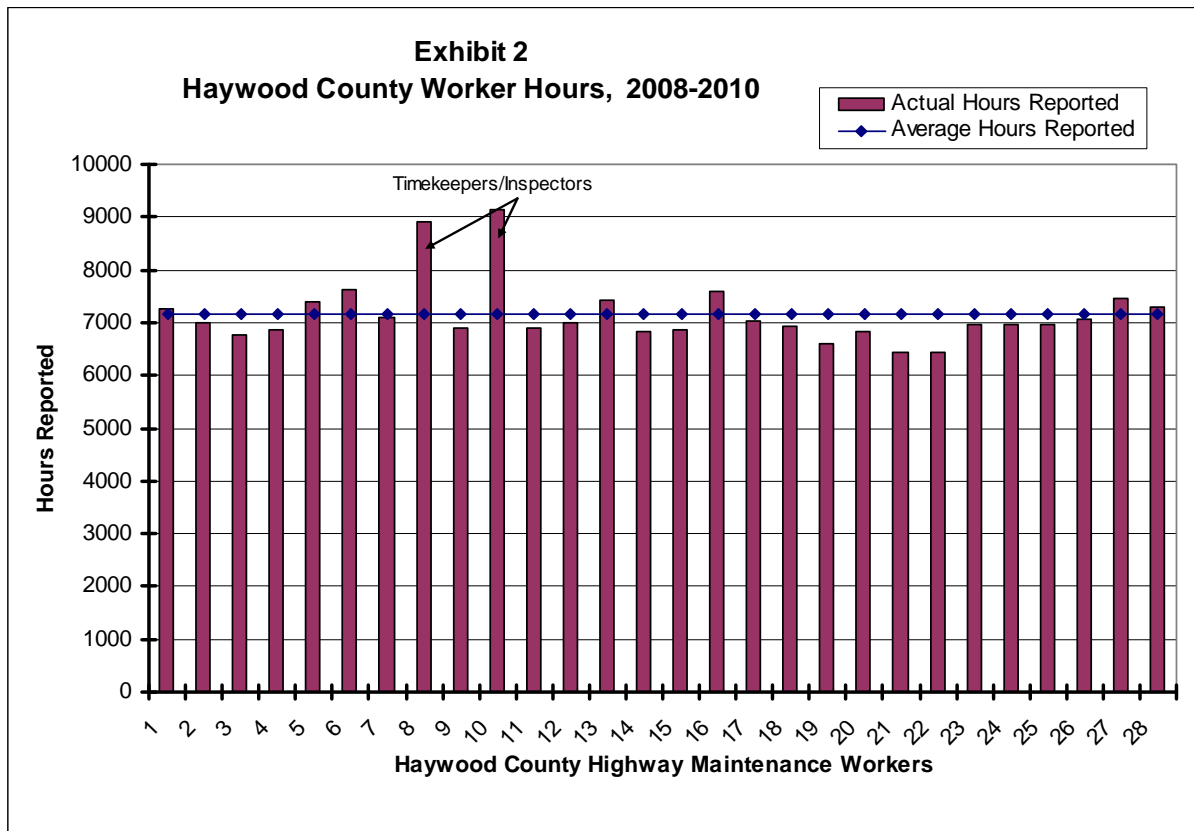
DOT management should consider actions to eliminate or mitigate the conflict of interest that exists between a DOT contractor and the Division's Contract Proposal Engineer. In addition, management should emphasize to employees the importance of fully disclosing any relationship that could create an actual or perceived conflict of interest with their DOT responsibilities.

DOT management should also consider disciplinary action related to the Contract Proposal Engineer for failing to disclose the extent of her secondary employment involvement with a DOT contractor.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

6. FAILURE TO EFFECTIVELY MONITOR WORK HOURS FOR TIMEKEEPERS RESULTED IN EXCESSIVE OVERTIME PAYMENTS.

Two employees in the Haywood County Maintenance Department were the only Timekeepers who routinely received overtime payments. Between January 1, 2008 and December 31, 2010, the two employees reported 26% more working hours than other Haywood County Maintenance Department employees (See Exhibit 2). Their overtime payments totaled \$107,000, representing 46% of their total compensation. These employees said that no one questioned them about their hours worked, and they did what they were told.



Employees Defended Hours Worked but Explanation Conflicted with Expectations

The two employees said they were responsible for overseeing the work of contractors and were required to stay on the job as long as the contractors worked. They also said that sometimes they provided traffic control before and after the contractors worked and had to ensure that the work area was left in a safe condition. In addition, the two employees said they had to complete paperwork associated with accounting for the contractor's hours.

The number of reported work hours for these employees was consistently three to four hours more per day than the hours reported by the contractors. DOT management and other timekeepers said that, generally, the number of work hours reported should be

FINDINGS AND RECOMMENDATIONS (CONTINUED)

consistent with the contractor's hours as the time needed to complete paperwork and inspect a worksite is not normally extensive. Other timekeepers stated that they completed paperwork while overseeing the contractors and that prison workers were often used for traffic control.

According to DOT policy, employees earn compensatory time for all hours worked over 40 in a week up to 50 hours. Any recorded time above 50 hours in a week must be paid monetarily. In addition, employees may accumulate up to 240 compensatory hours as "a means of being paid for those days an employee is unable to work due to weather conditions or slack or seasonal operations..."

The District 2 Engineer said DOT tries to manage overtime hours to stay within the range of compensatory time and minimize monetary overtime compensation.

Timesheet Approval Process

The Haywood County Road Maintenance Supervisor approved the two employees' timesheets even though he was not responsible for overseeing their activities. The Engineering Technician who oversaw their activities was instructed by the Maintenance Supervisor not to approve their timesheets because he was not these employees' supervisor.

The Maintenance Supervisor said that he questioned the extensive hours reported by the two employees and was assured by the two employees, the Engineering Technician, and the County Maintenance Engineer that they had worked the hours. However, when we questioned the Engineering Technician, he said he did not work overtime; therefore, he could not verify the timekeepers' hours or activities after normal working hours. The Maintenance Engineer said, "on occasion, he saw the timekeepers filling out paperwork after hours and they always appeared busy." However, he could not explain exactly what they were doing.

RECOMMENDATION

DOT management should ensure that work assignments that require the payment of overtime compensation receive prior approval and justification. The payment of overtime compensation should be closely monitored in accordance with DOT policy that requires the minimization of overtime pay.

DOT management should also ensure that only personnel with direct oversight responsibility for employees approve reported hours.

7. THE EMPLOYMENT OF CLOSE RELATIVES WITHIN THE SAME WORK UNIT VIOLATED DOT POLICY.

A Transportation Worker and the Haywood County Maintenance Engineer are first cousins. Both employees worked in the Haywood County Maintenance Department overseen by the County Maintenance Engineer. As such, the County Maintenance

FINDINGS AND RECOMMENDATIONS (CONCLUDED)

Engineer had ultimate authority over the Transportation Worker's timesheets and purchases. This may lead to preferential treatment in the Maintenance Department.

The Haywood County Road Maintenance Supervisor, who approved the timesheets for the Transportation Worker, reported directly to the County Maintenance Engineer. The Supervisor said that he was aware of the relationship but was never instructed by the County Maintenance Engineer to provide any benefits to the cousin. However, the Supervisor said that he had questions about the amount of overtime hours reported by the Transportation Worker. He said that, when he brought his concerns to the County Maintenance Engineer, he was assured that the cousin had worked the hours indicated and told to approve the timesheets.

In addition, the County Maintenance Engineer's signature stamp was used by his Office Assistant to approve purchase card transactions made by his cousin. The County Maintenance Engineer said that he did not realize he approved his cousin's purchases when his signature stamp was used by his Office Assistant. He agreed that it was probably inappropriate for him to approve his cousin's transactions.

The DOT Human Resources Manual regarding employment of relatives states:

- *A relative should not occupy a position which has influence over another family member's employment, transfer, promotion, salary administration, or other related management or personnel considerations.*
- *...It is also our position that any relatives outside of the immediate family shall also not be employed in the same working environment.*
- *Relatives outside of immediate family include: ...First Cousin...*

Because the County Maintenance Engineer and the Transportation Worker were considered "relatives outside of immediate family" and were employed in the same working environment, they violated DOT policy.

RECOMMENDATION

DOT management should adjust working assignments to ensure that these two employees are assigned to separate work units in accordance with DOT policy. Management should evaluate all work assignments within Division 14 to determine whether other circumstances exist regarding employment of relatives.



STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

BEVERLY EAVES PERDUE
GOVERNOR

EUGENE A. CONTI, JR.
SECRETARY

June 28, 2012

Beth A Wood, CPA, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601


RE: Response to Investigative Report, June 2012

Dear Ms. Wood:

In accordance with your letter dated June 13, 2012, I am responding to the audit findings noted in the Investigative Report titled Department of Transportation Division of Highways, Division 14. Enclosed you will find a written response and the corrective action plan for each audit finding.

Please contact Eric Boyette if you have any questions or concerns.

Sincerely,



Eugene A. Conti, Jr.
EAC/krw

Enclosure

cc: Jim Trogdon, PE, Chief Operating Officer, NCDOT
Terry Gibson, State Highway Engineer, NCDOT
Eric Boyette, Inspector General, NCDOT
David King, State Auditor's Office

OSA Investigative Report NCDOT Division of Highways, Division 14
NCDOT Responses to Findings and Recommendations

1. FAILURE TO CONTROL RENTAL EQUIPMENT COSTS CONTRIBUTED TO A MULTIMILLION DOLLAR PROJECT OVERUN.

We concur with the recommendation for this item. There was clearly a failure to monitor expenditures on the project and detect the project overruns in a timely manner. This was a result of not following internal processes, specifically:

- The District Engineer failed to monitor the project's expenses.
- The District Engineer failed to personally authorize FORE payments.
- Appropriate disciplinary actions for the District Engineer and County Maintenance Engineer were taken in accordance with NCDOT policies and procedures.

While NCDOT agrees with the recommendation, however, costs overruns on this project were due to the unique construction conditions and not totally related to FORE usage. NCDOT is in the process of creating standard reporting of FORE usage. Reports will include expenditures, contractors utilized and monthly summaries. The new FORE reports will allow managers the ability to better monitor and manage project expenses.

In addition, the Department will be suspending all FORE contracts in District 2 Division 14. All Division Engineers will review existing FORE contracts for appropriateness. The Chief Engineer will review existing FORE policy for required modifications and constraints vs standard PO contracts within 60 days.

2. FAILURE TO FOLLOW NCDOT'S CONTRACTING POLICIES FOR RENTAL EQUIPMENT UNNECESSARILY INCREASED THE COST OF HIGHWAY MAINTENANCE PROJECTS.

We concur with the finding on this item. Existing processes and internal controls have been strengthened since this project was reviewed.

These include:

- The District Engineer no longer delegates authority for approval of FORE payments.
- The Delegation of purchase approvals below the District Engineer for District 2 Division 14 has been eliminated.

All 14 divisions are now outsourcing a significant amount of work that helps maintain the highway system. The outsourcing has resulted in a decrease of NCDOT employees and equipment.

FORE contractors provide hourly pricing for their equipment after considering their transportation costs and other factors, which can result in different rates for similar equipment. NCDOT also considers responsiveness, work history, etc. when making decisions to continue to use contractors.

3. THREE NCDOT EMPLOYEES MADE EXCESSIVE PURCHASES, DISCOUNTS WERE LOST, AND ITEMS CANNOT BE LOCATED.

We concur with the recommendations for this item. Excessive purchases were made and additional controls have been established to ensure purchases are reviewed more thoroughly. Division 14 management amended the initial State Bureau of Investigation (SBI) report to provide additional information to the SBI.

The Office of Inspector General will conduct an audit of the Purchasing Card Program during the next Fiscal Year to ensure compliance and also investigate amended SBI report for possible submission of fraudulent report.

The Department is further investigating the finding and will take appropriate disciplinary action.

4. THE FAILURE TO FOLLOW THE APPROVAL PROCESS INCREASED THE RISK OF UNAUTHORIZED AND WASTEFUL PURCHASE CARD TRANSACTIONS.

We concur with the recommendation of this item. The Department's NCDOT Purchasing Card Manager is scheduling additional training for appropriate staff.

All P-Card use in District 2 Division 14 will be suspended until further notice.

The Office of Inspector General will conduct an audit of the Purchasing Card Program during the next Fiscal Year to ensure compliance and recommendations for improvement.

The Department is further investigating the finding and will take appropriate disciplinary action.

5. AN ENGINEER'S SECONDARY EMPLOYMENT CONFLICTED WITH NCDOT RESPONSIBILITIES.

We concur with the recommendation. The Employee will be placed on investigatory leave to determine disciplinary action.

A Department wide ethics reminder for all employees will be performed.

6. FAILURE TO EFFECTIVELY MONITOR WORK HOURS FOR TIMEKEEPERS RESULTED IN EXCESSIVE OVERTIME PAYMENTS.

We concur with the recommendation for this item. While the audit did not confirm any wrong doing related to overtime, the North Carolina Department of Transportation continues to review processes to that will ensure personnel are deployed efficiently. The recommendations will be addressed with all Divisions to ensure overtime is limited in accordance with NCDOT policies.

7. THE EMPLOYMENT OF CLOSE RELATIVES WITHIN THE SAME WORK UNIT VIOLATED NCDOT POLICY.

We concur with this item. The County Maintenance Engineer during the time of this report is no longer staffed in this location as of April 30, 2011. The position was filled with a new Engineer September 17, 2011. Division 14 is located in western North Carolina. Most of the facilities are located in rural areas with a limited pool of qualified and available workforce. The findings of the audit indicate violations to the North Carolina Department of Transportation policy regarding the employment of relatives.

The Department is further investigating the finding and will take appropriate disciplinary action.

In order to remedy the present violations and to eliminate the occurrence of future violations the North Carolina Department of Transportation is immediately implementing the following change. The Department has created a Relative Statement Form and will be reviewing the form with all current employees. The form requires employees to identify any relatives working within their Division or Unit and to certify under penalty of dismissal the accuracy of the information.

The process will be audited by the Office of Inspector General on a random cycle not to exceed 5 years.

The North Carolina Department of Transportation is confident the actions taken as described above along with the future audits described will ensure compliance with the policy regarding the employment of relatives.

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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2 South Salisbury Street
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Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

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