

STATE OF NORTH CAROLINA

FINANCIAL RELATED AUDIT

DEPARTMENT OF ADMINISTRATION

DIVISION OF PURCHASE AND CONTRACT

RETREAD TIRES

OCTOBER 2014

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

EXECUTIVE SUMMARY

PURPOSE

The Office of the State Auditor initiated this audit after concerns were raised about the quality of a particular retread tire supplied to the Department of Transportation (DOT) by one of the approved vendors.

BACKGROUND

White's Tire and other vendors provide retreaded tires to DOT under a state term contract for retread tires. A concern was raised about a specific type of retread tire provided to DOT by White's Tire that seemed out of compliance with contract specifications. Since January 9, 2009, the State has awarded four retread tire contracts for specific timeframes. The most recent retread tire contract was awarded by the Division of Purchase and Contract (P&C) in December 2013 and has an estimated annual dollar value of \$3 million. Five vendors share the current contract, including White's Tire.

KEY FINDINGS

- Lax contract administration led to 30% price increase and substandard tires costing \$89,000.
- Substandard tires and vendor failure to track tires not detected by P&C.

KEY RECOMMENDATIONS

- P&C should implement procedures to limit the possibility of non-contract periods occurring.
- P&C should monitor contractor performance on a regular basis and follow-up on matters of non-compliance.
- P&C should seek reimbursement from White's Tire for the cost of substandard retreads received.
- P&C should determine to what extent White's Tire should be able to sell retread tires under the current and future state contracts.

The key findings and recommendations in this summary are not inclusive of all the findings and recommendations in the report.



Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

October 30, 2014

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Mr. Bill Daughtride, Jr., Secretary, Department of Administration

This report presents the results of our financial related audit, titled Retread Tires, at the Department of Administration, Division of Purchase and Contract. The audit objectives were to determine if a vendor was out of compliance with contract specifications while providing the Department of Transportation with retread tires and whether the Department of Administration, Division of Purchase and Contract, monitored and properly administered the associated state term contract.

Secretary Daughtride reviewed a draft copy of this report. His written comments are included after each finding and in Appendix B.

The Office of the State Auditor initiated this audit after concerns were raised about the quality of a particular retread tire supplied to the Department of Transportation by one of the approved vendors.

Our audit identified matters that are considered reportable under *Government Auditing Standards*. These items are described in the *Audit Findings and Responses* section of this report.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the ways listed in the back of this report.

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

Beth A. Wood, CPA
State Auditor

TABLE OF CONTENTS

	PAGE
BACKGROUND	1
AUDIT OBJECTIVES AND SCOPE.....	2
METHODOLOGY.....	3
AUDIT FINDINGS AND RESPONSES	4
APPENDICES	
APPENDIX A: RUBBER SPECIFICATIONS OF RETREAD TIRES	10
APPENDIX B: AGENCY RESPONSE.....	11
ORDERING INFORMATION	13

[This Page Left Blank Intentionally]

BACKGROUND

Tire retreading is the process of replacing worn tire tread with a new tread for reuse. This process is also referred to as “recapping.” This process reduces the need to purchase new tires and encourages recycling.

In 1976, the State of North Carolina recognized the economic and environmental benefits of repairing and recapping worn tires on buses and larger trucks and began administering state term contracts for retread tires through the Department of Administration’s Division of Purchasing and Contract (P&C).

P&C is North Carolina’s central purchasing authority and helps state agencies save money by using the volume of statewide purchases to negotiate lower prices in state term contracts. P&C is the contract administrator for the retread tire contract and is charged with the authority and responsibility to monitor contract performance.

The retread tire contract has a number of requirements that the vendor must meet when providing retread tires to state agencies. Among the contractual requirements are retread rubber specifications, retreading methods, casing identification methods, and certain disclosure and reporting requirements. Each requirement is clearly defined and addressed in the contracts.

P&C awarded multiple tire retread term contracts over the past 38 years. The most recent tire retread contract was awarded in December 2013 with an estimated annual dollar value of \$3 million. White’s Tire and four other vendors were awarded the most recent contract. White’s Tire has been a vendor for the retread tire contract for more than 35 years.

AUDIT OBJECTIVES AND SCOPE

The audit objectives were to determine whether a vendor was out of compliance with contract specifications while providing the Department of Transportation (DOT) with retread tires and whether the Department of Administration, Division of Purchase and Contract, monitored and properly administered the associated state term contract.

Our audit scope included pre-cured size 11R22.5 lug (traction) retread tires provided to DOT by White's Tire from January 9, 2009, to March 14, 2014.

METHODOLOGY

To accomplish the audit objectives, auditors interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions, as considered necessary in the circumstances.

Auditors also considered North Carolina General Statutes, the tire retreading term contracts, the “*State of North Carolina Contract Administration and Monitoring Guide*,” and the *State Procurement Manual* to identify improvements in P&C’s monitoring of statewide term contracts.

As a basis for evaluating internal control, auditors applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment; (2) risk assessment; (3) control activities; (4) information and communication; and (5) monitoring.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT FINDINGS AND RESPONSES

1. LAX CONTRACT ADMINISTRATION LED TO 30% PRICE INCREASE AND SUBSTANDARD TIRES COSTING \$89,000

The Department of Administration, Division of Purchase and Contract (P&C), did not follow its contract bid administration procedures nor take the necessary administrative steps to ensure that there were retread tire contracts in place for the period under audit.

As a result, the State:

- Experienced a 30% contract price increase per retread tire.
- Paid \$89,000 for substandard tires.

30% Contract Price Increase per Retread Tire

P&C did not follow its contract bid administration procedures and either award the contract within 45 days of accepting bids or obtain written confirmations from the vendors that they would continue to honor their bid prices. Instead, P&C awarded the contract 84 days after bids were received without obtaining bid award extension confirmations from the vendors.

As a result, White's Tire was able to increase its bid price by 30%. White's Tire notified P&C that it was unable to honor its \$102 bid price due to increases in raw material costs and asked to be removed from the list of authorized vendors. After White's Tire withdrawal, P&C canceled the contract and began working on a new Invitation For Bid (IFB). White's Tire then submitted a new bid and was awarded the contract for \$133 per retread.

The cost increase to the State could have been avoided if P&C had followed its contract bid administration procedures. P&C's bid requirements specify that vendors guarantee their prices for up to 45 days. If a contract is not awarded within 45 days, P&C's bid administration procedures require that it confirm, in writing, that vendors can still honor the bid price. P&C refers to this as a "bid award extension confirmation."

Paid \$89,000 for Substandard Tires

P&C did not take the necessary administrative steps to ensure that there was a contract in place for tire retreading services during the 8-month period from November 1, 2012, through July 1, 2013.

During that time, Department of Transportation (DOT) paid \$89,000 to White's Tire for about 900 retread tires that had a lower quality rubber than that required when a contract was in place.

However, the State is unlikely to be able collect any of the \$89,000 spent on the retread tires. Because there was no contract in place at the time, the quality of the tires did not actually violate any contract terms. Consequently, the State may have no recourse.

AUDIT FINDINGS AND RESPONSES

There was no contract in place because of P&C's administrative actions. On October 19, 2012, P&C notified all bidding vendors that it cancelled the 2012 IFB¹ due to an abnormally low number of bids. In this IFB, six bids were received from five potential vendors.² P&C management stated that since only half the number of bids was received in comparison to previous years, there was an increased risk of the State entering into a poor contract for tire retread services and products.

But P&C did not take timely action to put a new contract in place. A second IFB was not advertised until April 9, 2013, (172 days later), and the next term contract was not executed and in force until July 2, 2013 (256 days later).

Statewide term contracts are necessary to help agencies control costs without sacrificing quality. In fact, P&C's *State Procurement Manual*³ lists obtaining lower prices through volume discounts and obtaining items that have established standards and have been tested as two considerations in establishing statewide term contracts.

Recommendations:

P&C should implement necessary safeguards and procedures to limit the possibility of non-contract periods occurring.

Agency Response:

The Department and Division are in general agreement with the Report's conclusion that certain contract administration procedures were not adequately observed.

First, following the period covered in this Report, the Division has undergone a complete restructuring with a turnover of twenty-three of the Division's thirty-eight positions – including almost every position with term-contract administration responsibilities. Contract administration training is also now in place. All Division procedures have been reviewed, documented and improved where needed. Emphasis has been placed on communication and feedback from agency users and vendors to ensure satisfaction with the goods and services purchased. In summary, the Division has corrected the contract administration deficiencies identified in this Report.

Second, concerning Finding number 1 that lax contract administration led to a 30% price increase and substandard tires costing \$89,000, the Division cannot assume that had the Division requested White's to hold its offer open for longer than 45 days, White's would have agreed to do so. Even then, White's may have been agreeing to provide retreading at a price unsustainable in the face of raw material increases. The Division acknowledges it erred in not making such a request.

¹ Invitation for Bid 201201303

² The prior IFB had 15 bids from ten contractors.

³ Section 1.3.5

AUDIT FINDINGS AND RESPONSES

2. SUBSTANDARD TIRES AND VENDOR FAILURE TO TRACK TIRES NOT DETECTED BY P&C

The Department of Administration, Division of Purchase and Contract (P&C), did not monitor the retread tire contract⁴ for vendor compliance and did not know that:

- Substandard tires were sold to the Department of Transportation (DOT).
- Tire casings were not electronically tracked and reported.

Monitoring for compliance with the contract's rubber compound specifications, tread depth, and reporting requirements is essential to ensure the vendor delivers what agencies pay for.

No Monitoring of Vendor Compliance

P&C provided no evidence that it actively monitored the contracts⁵ to determine whether vendors were complying with the terms of contracts.

P&C management stated that staffing shortages are one reason for P&C's lack of monitoring. P&C management commented that contract monitoring was a low-priority activity in comparison to the day-to-day administration of state term contracts due to staffing shortages.

P&C management also stated that delegation of monitoring responsibilities to state agencies is another reason for P&C's lack of monitoring. P&C takes the approach that state agencies are in a better position to perform contract monitoring since they are the entities that actually receive the goods or services.

Law Requires P&C to Monitor

State law⁶ prohibits P&C from delegating its contract monitoring responsibilities to state agencies. State law says that the Secretary of Administration has the responsibility "to monitor and enforce the terms and conditions of statewide term contracts" and "shall not delegate the power and authority to any other department, agency, or institution of the State."

Also, best practices include contract monitoring. Specifically, the National State Auditor Association's "Best Practices in Contracting for Services" states:

"Contract monitoring is an essential part of the contracting process. Monitoring should ensure that contractors comply with contract terms, performance expectations are achieved, and any problems are identified and resolved. Without a sound monitoring process, the contracting agency does not have adequate assurance it receives what it contracts for."

⁴ State term Contact 928A – Retread Tires

⁵ There are four contracts included in the scope of this audit. See appendix A for contract periods.

⁶ NCGS § 143-49 Powers and Duties of the Secretary.

AUDIT FINDINGS AND RESPONSES

Substandard Tires provided to DOT

Since it did not monitor for compliance, P&C did not determine that DOT received approximately 65 substandard retread tires from White's Tire Service, Inc. (White's Tire) during the contract period of July 2, 2013, to October 15, 2013.⁷

DOT paid about \$6,400 for retread tires that did not meet state business and quality requirements. With the assistance of DOT, P&C established specific state requirements for the tire retreads to ensure a quality product that would satisfy business and safety needs.

The retread tires did not meet state requirements in two ways.

First, all 65 retread tires that White's Tire supplied to DOT failed to meet at least some of the eight rubber compound specifications required by the state term contracts.⁸ White's Tire supplied DOT with Vipal Ruzimold⁹ R167B model retreads that did not meet contract specifications in three out of eight (37.5%) rubber compound categories in this contract period.¹⁰

Second, all 65 retread tires that White's Tire supplied to DOT failed to meet the tread depth in the state term contracts. In this contract period,¹¹ the contract required a minimum tread depth of 24/32 inches. However, White's Tire supplied DOT with 65 retreads that had a tread depth of 18/32 inches (25% less than required).

The state retread contract does not allow vendors to deviate from the contract specifications without prior approval. The specification clause of P&C's retread contracts states:

“Any deviation from specifications indicated herein must be clearly pointed out; otherwise, it will be considered that items offered are in strict compliance with these specifications, and bidder will be held responsible therefore.”

According to P&C management, White's Tire did not have approval from the State to deviate from the contract specifications. Based on a review of bid documents and contracts, auditors concluded that White's Tire did not point out any deviations from the required specifications.

⁷ First delivery of Vipal Ruzimold R167B tread was received by White's Tire in September 2012. However, it is unclear if any of this tread was provided to DOT during the contract period ending October 31, 2012. Auditors determined that 900 were provided during the non-contract period from November 1, 2012, to July 1, 2013 (See Finding #1).

⁸ A representative of the retread manufacturer confirmed compound differences between the retread material used and the contract specifications. A review of the retread manufacturer's technical data sheets shows that the material did not meet contract specifications in the areas of tensile strength, elongation, specific gravity, modulus @ 300%, and polybutadine content during at least one of the contract periods (See Appendix A for detail).

⁹ This manufacturer is different than the one bid and agreed to for the periods January 9, 2009, to September 30, 2010, and October 1, 2010, to October 31, 2012.

¹⁰ July 2, 2013, to October 15, 2013.

¹¹ July 2, 2013, to October 15, 2013.

AUDIT FINDINGS AND RESPONSES

Vendor Did Not Track Tires

Additionally, P&C did not determine that White's Tire failed to electronically track and provide reports on individual tire casings.¹² Agencies could use these reports to assure that they were returned the same tire casings that they sent for retreading. Failure to properly track and ensure that the correct tires are returned to each state agency is a recurring problem.

The lack of proper tracking for tire casings was first identified in the Office of the State Auditor's 2006 investigative report¹³ about a previous tire retreading contract with White's Tire. At that time P&C agreed with the finding and proposed action to correct the problem. However, P&C did not monitor the current contract to ensure that the problem did not recur.

Recommendations:

P&C should monitor contractor performance on a regular basis and follow-up on any matters of non-compliance.

The State should seek reimbursement from White's for the cost of substandard retreads received.

P&C should determine to what extent White's should be able to sell retread tires under current and future state contracts.

Agency Response:

The Department and Division are in general agreement with the Report's conclusion that certain contract administration procedures were not adequately observed.

The audit Report notes that P&C management delegated contract monitoring responsibilities to State agencies. The Division is aware of its statutory duties, but it does rely on agencies to report vendor noncompliance issues when they become aware of them. Because agencies receive and use the term contract goods and services, they often are the first to recognize or experience compliance problems. As noted earlier, the Division has corrected the contract administration deficiencies identified in this Report.

Lastly, concerning White's failure to utilize an electronic system to track and report on State-owned tire casings as required in the term contract, the Division announced in its pre-bid conference for the current contract that it would confirm the use of an electronic system by successful vendors during the current contract term. The Division has already addressed this issue with White's, and White's has committed to implement an existing electronic tracking system immediately.

¹² A tire casing is the main body of the tire exclusive of the tread and tube.

¹³ INV-2006-0307, North Carolina Department of Administration Division of Purchase and Contract, page 8

AUDIT FINDINGS AND RESPONSES

Within the next thirty days, the Division will follow up with White's to discuss the issues raised in this audit report and proposed corrective action by White's to ensure future compliance. If the parties are not able to reach agreement on appropriate remedial action, then the Division intends to institute more formal proceedings regarding White's ability to do business with the State.

APPENDIX A

RUBBER SPECIFICATIONS OF RETREADS PROVIDED BY WHITE'S TIRE

Contract Period	RUBBER COMPOUND SPECIFICATIONS ¹⁴					TREAD DEPTH
	Meets Tensile Strength	Meets Elongation	Meets Modulus @ 300%	Meets Specific Gravity	Meets Polybutadine Content	Meets Tread Depth
January 9, 2009 - September 30, 2010	N/A - no Ruzimold R167B treads were provided to DOT by White's during this period.					
October 1, 2010 - October 31, 2012	N/A - no Ruzimold R167B treads were provided to DOT by White's during this period.					
July 2, 2013 - October 15, 2013	NO	NO	YES	NO	YES	NO
December 4, 2013 - Current:	N/A - no Ruzimold R167B treads were provided to DOT by White's after 8/19/2013.					

¹⁴ Three additional rubber compound categories were reviewed that met contract specifications.

APPENDIX B AGENCY RESPONSE



North Carolina Department of Administration

Pat McCrory, Governor

Bill Daughtride, Jr., Secretary

October 23, 2014

The Honorable Beth Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0604

Dear Ms. Wood:

Thank you for the opportunity to review and comment on the draft report concerning the financial related audit your office has recently conducted of the statewide term contract for tire retreading services, established by the Department's Division of Purchase and Contract.

The Department and Division are in general agreement with the Report's conclusion that certain contract administration procedures were not adequately observed. Additional explanation is provided to address the contract administration findings.

First, following the period covered in this Report, the Division has undergone a complete restructuring, with a turnover of twenty-three of the Division's thirty-eight positions—including almost every position with term-contract administration responsibilities. Contract administration training is also now in place. All Division procedures have been reviewed, documented and improved where needed. Emphasis has been placed on communication and feedback from agency users and vendors to ensure satisfaction with the goods and services purchased. In summary, the Division has corrected the contract administration deficiencies identified in this Report.

Second, concerning Finding number 1 that lax contract administration led to a 30% price increase and substandard tires costing \$89,000, the Division cannot assume that had the Division requested White's to hold its offer open for longer than 45 days, White's would have agreed to do so. Even then, White's may have been agreeing to provide retreading at a price unsustainable in the face of raw material increases. The Division acknowledges it erred in not making such a request.

The audit Report notes that P&C management delegated contract monitoring responsibilities to State agencies. The Division is aware of its statutory duties, but it does rely on agencies to report vendor noncompliance issues when they become aware of them. Because agencies receive and use the term contract goods and services, they often are the first to recognize or experience compliance problems. As noted earlier, the Division has corrected the contract administration deficiencies identified in this Report.

Mailing Address:
1301 Mail Service Center
Raleigh, N.C. 27699-1301

Telephone (919) 807-2425
Fax (919) 733-9571
State Courier #51-01-00
e-mail: bill.daughtride@doa.nc.gov

Location:
116 West Jones Street
Raleigh, North Carolina

An Equal Opportunity/Affirmative Action Employer

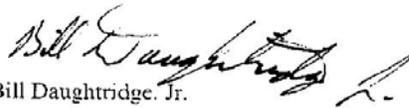
APPENDIX B AGENCY RESPONSE

Page 2
The Honorable Beth Wood
October 23, 2014

Lastly, concerning White's failure to utilize an electronic system to track and report on State-owned tire casings, as required in the term contract, the Division announced in its pre-bid conference for the current contract that it would confirm the use of an electronic system by successful vendors during the current contract term. The Division has already addressed this issue with White's, and White's has committed to implement an existing electronic tracking system immediately.

Within the next thirty days, the Division will follow up with White's to discuss the issues raised in this audit report and proposed corrective action by White's to ensure future compliance. If the parties are not able to reach agreement on appropriate remedial action, then the Division intends to institute more formal proceedings regarding White's ability to do business with the State.

Sincerely,



Bill Daughtridge, Jr.

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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

Telephone: 919-807-7500

Facsimile: 919-807-7647

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

To report alleged incidents of fraud, waste or abuse in state government contact the:

Office of the State Auditor Fraud Hotline: 1-800-730-8477

or download our free app



<https://play.google.com/store/apps/details?id=net.ncauditor.ncauditor>



<https://itunes.apple.com/us/app/nc-state-auditor-hotline/id567315745>

For additional information contact:

Bill Holmes
Director of External Affairs
919-807-7513

This audit required 1,812.5 audit hours at a cost of \$130,500.