

STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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January 30, 2006

Dr. Kenneth E. Peacock, Chancellor
Appalachian State University
B. B. Dougherty Administration Bldg., Box 32002
Boone, North Carolina 28608

Dear Chancellor Peacock:

We received information last year concerning an out-of-state business named Stone Cold Chemicals, Inc. (Stone Cold). Allegedly, Stone Cold charged its customers four to ten times fair market value for janitorial and maintenance products and provided gifts to purchasing agents, including an employee of Appalachian State University (ASU).

We have completed a special review of these allegations. The following findings and recommendations are based on an examination of various financial documents and records, review of applicable policies and statutes, and interviews of ASU personnel and former employees of Stone Cold.

Stone Cold Chemicals, Inc.

Stone Cold was a telemarketing business that sold industrial chemicals and cleaners. The business primarily sold its products at inflated prices to purchasing agents that accepted gifts for the purchases. The gifts were referred to as "premiums" on internal sales reports and ranged in value from 8 to 10% of each sale.

Stone Cold maintained offices in Georgia and Florida. In January 2003, investigators from the Georgia Bureau of Investigation and the Walton County (Georgia) Sheriff's Office closed and searched Stone Cold's Georgia office. In March 2003, investigators from the Florida Department of Law Enforcement closed and searched Stone Cold's Florida office. Investigators seized all documents, records, and computers from both offices as evidence for criminal prosecution. Several Stone Cold employees were prosecuted for criminal violations in the State of Florida.

Acceptance of Gifts in Violation of North Carolina State Law

Our review found that ASU's Physical Plant Purchasing Agent authorized 15 purchases from Stone Cold totaling \$5,066.01 from October 1999 through March 2002. According

to Stone Cold's internal sales reports, the ASU Purchasing Agent received "premiums" valued at \$325.00 for these purchases. The premiums were in the form of gift cards to Lowe's and Bass Pro Shops. The gift cards ranged in value from \$20 to \$50 and were sent by mail to the Purchasing Agent's home address.

In our opinion, the Purchasing Agent's acceptance of these gift cards was a violation of North Carolina General Statute § 133-32, Gifts and favors regulated.

§ 133-32. Gifts and favors regulated.

(a) It shall be unlawful for any contractor, subcontractor, or supplier who:

- (1) Has a contract with a governmental agency; or
- (2) Has performed under such a contract within the past year; or
- (3) Anticipates bidding on such a contract in the future

to make gifts or to give favors to any officer or employee of a governmental agency who is charged with the duty of:

- (1) Preparing plans, specifications, or estimates for public contract; or
- (2) Awarding or administering public contracts; or
- (3) Inspecting or supervising construction.

It shall also be unlawful for any officer or employee of a governmental agency who is charged with the duty of:

- (1) Preparing plans, specifications, or estimates for public contracts; or
- (2) Awarding or administering public contracts; or
- (3) Inspecting or supervising construction

willfully to receive or accept any such gift or favor.

(b) A violation of subsection (a) shall be a Class 1 misdemeanor.

(c) Gifts or favors made unlawful by this section shall not be allowed as a deduction for North Carolina tax purposes by any contractor, subcontractor or supplier or officers or employees thereof.

(d) This section is not intended to prevent the gift and receipt of honorariums for participating in meetings, advertising items or souvenirs of nominal value, or meals furnished at banquets. This section is not intended to prevent any contractor, subcontractor, or supplier from making donations to professional organizations to defray meeting expenses where governmental employees are members of such professional organizations, nor is it intended to prevent governmental employees who are members of professional organizations from participation in all scheduled meeting functions available to all members of the professional organization attending the meeting. This section is also not intended to prohibit customary gifts or favors between employees or officers and their friends and relatives or the friends and relatives of their spouses, minor children, or members of their household where it is clear that it is that relationship rather than the business of the individual concerned which is the motivating factor for the gift or favor. However, all such gifts knowingly made or received are required to be reported by the donor to the agency head if the gifts are made by a contractor, subcontractor, or supplier doing business directly or indirectly with the governmental agency employing the recipient of such a gift. (1981, c. 764, s. 1; 1987, c. 399; 1993, c. 539, s. 970; 1994, Ex. Sess., c. 24, s. 14(c).)

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Inflated Purchase Prices

We also found that the Purchasing Agent purchased cleaning products at up to ten times the comparable market prices for similar products. For the 12 products the Purchasing Agent acquired from Stone Cold, we compared the purchase price to prices for similar items at local outlets. This comparison confirmed that ASU paid \$4,667.81 for products with a fair market value of \$1,056.64, an excess of \$3,611.17.

We also determined that Stone Cold added an extra \$10 to the shipping charges for each invoice. Actual shipping charges should have totaled \$248.20, but ASU paid \$398.20, an excess of \$150.00.

Recommendations

ASU should take appropriate disciplinary action in response to the Purchasing Agent's conduct. In addition, ASU officials should ensure that all ASU employees with purchasing responsibilities understand and comply with applicable statutes and policies governing the receipt of gifts and favors from vendors. A signed acknowledgement of this understanding should be maintained on file for these employees.

Please provide your written response to these findings and recommendations, including corrective actions taken or planned, by February 15, 2006. In accordance with General Statute § 147-64.6(c)(12), the Governor, the Attorney General, the District Attorney for the 24th Judicial District, and other appropriate officials, will receive a copy of this management letter. If you have any questions or wish to discuss this matter further, please contact us. We appreciate the cooperation received from the employees of Appalachian State University during our review.

Sincerely,



Leslie W. Merritt Jr., CPA, CFP
State Auditor

Management letter and responses receive the same distribution as audit reports.

February 14, 2006

Mr. Leslie W. Merritt, CPA, CFP
State of North Carolina
Office of the State Auditor
2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601

Dear Mr. Merritt:

I received your January 30, 2006 management letter that details your special review of allegations that an employee of Appalachian State University received gifts from a vendor that charged the University several times fair market value for its goods. I wish to respond to your recommendations as follows.

Recommendation: "ASU should take appropriate disciplinary action in response to the Purchasing Agent's conduct."

Response: The Purchasing Agent retired on February 1, 2006, as announced to his colleagues on January 10, 2006. Hence, we are precluded from exercising employment discipline against the individual. You may rest assured that we will explore opportunities to collect funds overpaid by the University as a result of the former employee's misconduct. University staff members have cooperated fully with law enforcement officials investigating the case, and we will further support prosecution of criminal charges if the District Attorney determines such action to be appropriate.

Recommendation: "In addition, ASU officials should ensure that all ASU employees with purchasing responsibilities understand and comply with applicable statutes and policies governing the receipt of gifts and favors from vendors. A signed acknowledgment of this understanding should be maintained on file for these employees."

Response:

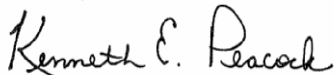
1. Each ASU employee with significant purchasing responsibilities will have a section in his or her work plan that will require the employee to read the applicable statutes and policies on receipts of gifts and favors from vendors. The section will also require these employees to know, understand and follow established ASU purchasing policies and procedures. By signing the work plan, the employee acknowledges and agrees with all sections of the plan.

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2. Our Director of Internal Audits already has recommended updates to purchasing policies and procedures. They will include specific references to statutes that prohibit the conduct described in your letter. Our legal counsel has identified North Carolina General Statutes, sections 143-58.1 and 14-234 for inclusion in addition to section 133-32, which was referenced in your letter and appears to address regulation of contractors on public works projects. In addition, the Director of Internal Audits will send a notice to all employees that addresses purchasing scams in general and specifically mentions that N.C. General Statutes make it unlawful for employees to accept gifts and favors from vendors in exchange for entering into an agreement to purchase products or enter into any other type of contract.
3. We expect orientation of all new employees to include training on compliance with State law governing the purchasing function.

Appalachian State University takes seriously its obligations to comply with State law in all of its functions, and we appreciate your bringing this matter to our attention.

Sincerely,

A handwritten signature in cursive script that reads "Kenneth E. Peacock".

Kenneth E. Peacock
Chancellor