



STATE OF NORTH CAROLINA

SPECIAL REVIEW

NORTH CAROLINA STATE UNIVERSITY

FACILITIES OPERATIONS DEPARTMENT

RALEIGH, NORTH CAROLINA

AUGUST 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

SPECIAL REVIEW

**NORTH CAROLINA STATE UNIVERSITY
FACILITIES OPERATIONS DEPARTMENT**

RALEIGH, NORTH CAROLINA

AUGUST 2006



Leslie W. Merritt, Jr., CPA, CFP
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

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Dr. James L. Oblinger, Chancellor, North Carolina State University

Pursuant to North Carolina General Statute § 147-64.6(c) (16), we have completed a special review of allegations concerning an employee of the North Carolina State University - Facilities Operations Department. The results of our review, 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 North Carolina General Statute § 147-64.6 (c) (12) which requires the State Auditor to provide written notice of apparent instances of violations of penal statutes or apparent instances of malfeasance, misfeasance, or nonfeasance by an officer or employee.

Leslie W. Merritt, Jr.

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

August 28 , 2006

TABLE OF CONTENTS

	PAGE
INTRODUCTION.....	1
BACKGROUND.....	3
FINDINGS AND RECOMMENDATIONS.....	5
RESPONSE FROM NORTH CAROLINA STATE UNIVERSITY.....	11
ORDERING INFORMATION.....	15

INTRODUCTION

The Office of the State Auditor received an allegation through the State Auditor's Hotline concerning an employee of the North Carolina State University (NCSU) - Facilities Operations Department. Allegedly, the employee wrote specifications for building maintenance projects, participated in the bid solicitation and selection process and sold equipment to a contractor that was awarded a contract. This employee allegedly also oversaw the performance of a convenience maintenance contract awarded to the same contractor.

To conduct a special review of these allegations, we performed the following procedures:

- Interviews with employees of the contractor, NCSU Facilities Operations management, and NCSU Purchasing Department staff;
- Examination of relevant documents and records from both the contractor and NCSU;
- Review of applicable NCSU policies and North Carolina General Statutes.

This report presents the results of our special review. The review was conducted pursuant to North Carolina General Statute § 147-64.6(c) (16) rather than as a financial or performance audit. The Office of the State Auditor performs a financial statement audit of North Carolina State University on an annual basis.

[This Page Left Blank Intentionally]

BACKGROUND

Facilities Operations is one of four departments within the NCSU Facilities Division. The Facilities Operations Department provides facility maintenance, grounds services, and housekeeping services for the entire campus.

The Facilities Operations Department employs two Facility Mechanical Engineers as Project Managers to assist in mechanical and electrical systems maintenance. Facilities Operations has divided the campus into seven maintenance service zones and the Project Managers work in any of these zones. Project managers oversee the “non-routine” maintenance as requested by maintenance supervisors or as directed by Facilities Management. For instance, when a system breaks down, it is the project manager’s responsibility to decide how to address the situation through repair or replacement of the existing equipment.

For smaller repair and maintenance projects, the work is completed under a convenience contract.¹ This allows the work to be assigned by having the contractor simply provide a quote for the work to be performed. For these jobs, project managers receive the quotes and ensure that the work is performed by the contractor.

For larger projects, a formal bid process is used. Project managers identify jobs that may require a formal bid and then they either develop the specifications or assist in the development. In addition, the project manager reviews the bids for compliance with the specifications and consults on any adjustments that might be made to the specifications.

The project managers work very closely with contractors in coordinating work and consulting on issues related to a project. Project managers exercise discretion in determining when a piece of equipment requires repair or replacement. They are also expected to utilize their expertise in writing specifications to resolve maintenance issues in the most cost efficient manner.

¹ Smaller projects are typically less than \$30,000. A convenience maintenance contract is awarded to a contractor based on a public bid for a period of two years. If the dollar amount of a project exceeds the annual amount remaining under the convenience contract, that project must go to public bid.

[This Page Left Blank Intentionally]

FINDINGS AND RECOMMENDATIONS

1. A PROJECT MANAGER USED HIS UNIVERSITY POSITION TO DERIVE A DIRECT BENEFIT FOR HIS PRIVATE BUSINESS.

On September 8, 2005, the NCSU Purchasing Department approved the purchase and installation of a 650-ton electrical centrifugal chiller at the NCSU Engineering Graduate Research Center. The public bids for this contract were reviewed in accordance with North Carolina General Statute § 143.3B. The contract was awarded to Industrial Turnaround Corporation (ITAC) as the low bidder at a total cost of \$257,025.

In his capacity as a Facility Mechanical Engineer, an NCSU project manager (the project manager) wrote specifications for the purchase and installation of the chiller. In addition, he was also involved in the public bid review and amendment process.

ITAC completed a purchase agreement for the chiller from a company called GIA dba Temperature Control Technology (TCT). ITAC representatives raised concerns about a joint payment agreement between GIA/ITAC and Thermal Components, an authorized chiller distributor located in Lenexa, Kansas. An ITAC employee approved the agreement against standard ITAC policy. The ITAC official said he also became concerned because it is more typical to deal with the authorized distributor directly.

When ITAC officials attempted to contact a representative with TCT, they discovered that a project manager with the NCSU Facilities Operations Department may have had a relationship with TCT. After learning about this possible conflict of interest, ITAC officials cancelled the purchase order, removed their employee from any further involvement with the project pending further investigation.²

According to the purchase order obtained from ITAC dated October 11, 2005, the supplier for the chiller was Temperature Control Technology with an address and phone number located in Overland Park, Kansas. A fax phone number shown on the document was the personal phone number of the project manager.

A review of the project manager's NCSU computer revealed information related to a quote submitted in response to a bid dated December 15, 2003 for a 400-ton chiller at Research Building 3 on the NCSU campus. The specifications for this bid were written by the project manager. The quote was for \$217,000 and was made by TCT/Comfort Products. Contact information included with the quote indicated the project manager's involvement. In addition, a credit application submitted by TCT to Comfort Products showed the project manager as the owner of GIA dba TCT.

² The employee resigned from his position with ITAC shortly thereafter.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

The NCSU Purchasing Department provided information related to the above bid that included a quote submitted by INCO, Inc. for \$216,600. The bid was subsequently awarded to INCO, Inc. as the low bidder. We located a quotation sheet from TCT on the project manager's computer to sell a chiller for \$132,703 to a company called INCO, Inc. The person shown on the quotation as the contact for INCO, Inc. is the same employee at ITAC who was involved with the transaction described above.³

When we interviewed the project manager concerning this bid, he acknowledged submitting it. When we asked the project manager if he had conversations with the INCO employee during the bid process, he said "no, not really." When asked what "not really" meant, he admitted they had talked about the project. The project manager also admitted that he had sold the chiller to INCO with approximately a \$10,000 mark-up. In response to questions about two other quotes from TCT to the NCSU Purchasing Department, he said, "might be, the name of the company is there so I have to take responsibility."

In addition to the above transactions, TCT sold other equipment to ITAC. The table below is a detailed vendor history that identifies invoices from TCT to ITAC for equipment that was purchased by ITAC directly from TCT and used in other projects at NCSU as well as projects not related to NCSU.

Invoice Date	Invoice Amount	Project Location	Payment Date
11/22/05	\$759.70	NCSU Patterson Hall	12/12/05
11/22/05	834.60	Bath Building (State Govt.)	12/12/05
11/22/05	560.00	Peace College	12/12/05
1/26/06	3,864.75	NCSU MRC Building	2/13/06
1/26/06	<u>8,089.20</u>	Peace College	2/13/06
	<u>\$14,108.25</u>		

ITAC issued a check to TCT dated December 12, 2005 in the amount of \$2,154.30 that was not cashed as of the date of our review. A check from ITAC to TCT for \$11,953.95 dated February 13, 2006 was processed. The check was sent to the projects manager's personal residence and endorsed by the project manager.

North Carolina General Statute § 14-234 states:

(a) (1) "No public officer or employee who is involved in making or administering a contract on behalf of a public agency may derive a direct benefit from the contract..." (a1) (2) "A public officer or employee is involved in administering a contract if he or she oversees the performance of the contract or has authority to make decisions

³ Prior to working with ITAC, this individual was previously employed by INCO, Inc. INCO held the convenience maintenance contract with NCSU prior to ITAC being awarded the contract.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

regarding the contract or to interpret the contract. (3) A public officer or employee is involved in making a contract if he or she participates in the development of specifications or terms or in the preparation or award of the contract...” (4) “A public officer or employee derives a direct benefit from a contract if the person or his spouse: (i) has more than a ten percent (10%) ownership or other interest in an entity that is a party to the contract; (ii) derives any income or commission directly from the contract; or (iii) acquires property under the contract...”

As an employee of the NCSU Facilities Operation Department, the project manager had a fiduciary duty to place the interests of NCSU above his personal business interests. The project manager’s position required him to write specifications for projects involving the purchase and installation of equipment that required the submission of bids. By submitting a bid on behalf of his own business, interacting with another company’s representative that also submitted bids to NCSU, and selling equipment to that company for a profit, we believe the project manager violated the provisions of the above state law and his fiduciary responsibility to NCSU.

RECOMMENDATIONS

NCSU should establish policies and procedures related to construction contracts that require an “audit clause” in the contract that would allow NCSU to review information related to any subcontractors, suppliers or other vendors that may be furnishing equipment or services to the primary contractor. We also recommend NCSU perform periodic comparisons of NCSU employee information and vendor information to determine if an employee is receiving payments from NCSU as a vendor or contractor.

Note: This finding has also been referred to the District Attorney for the 10th Prosecutorial District of North Carolina.

2. THE PROJECT MANAGER FAILED TO DISCLOSE SECONDARY EMPLOYMENT TO UNIVERSITY MANAGEMENT.

The project manager began employment with NCSU on August 5, 2002. The project manager’s employment application indicated that he was employed by Temperature Control Technology (TCT) for a four-month period beginning on July 10, 2001.⁴

⁴ We traced the contact information for TCT on the employment application to a company named Temperature Control Technology that was incorporated in the Commonwealth of Virginia on February 13, 2002 and terminated on July 3, 2003.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

We obtained an image of the project manager's NCSU computer and discovered numerous files that contained various documents such as purchase orders, invoices, job quotations and correspondence related to the business dealings of a company called GIA dba Temperature Control Technology. The documents were dated subsequent to his start of employment with NCSU. The documents also indicated an ongoing business relationship with various heating and air conditioning contractors and vendors in North Carolina as well as other states.

The computer also had a resume for an individual that was shown as a contact on some of the business documents. We determined that this individual had recently received a graduate degree in Architecture from NCSU and, according to records at the Registrar's office, had a forwarding address located in New Jersey. We also identified the name of the "proprietor" of GIA dba TCT as the spouse of the project manager.

When we interviewed the project manager regarding the documents found on his computer and his involvement with TCT, he admitted doing business as TCT and stated that his wife, who is a biology major and works as a physician's assistant at a local hospital, "sort of runs it" and that he does not do "much at all." The project manager said "it is really not much of a business."⁵

We questioned the project manager about the reality of his wife's involvement considering her educational background and the project manager conceded that he oversaw the business activities of TCT. He said he did not advertise his services but contractors came to him requesting his assistance in procuring equipment for them.

The contact information included on the documents found on the project manager's computer indicated an office location and telephone number in Overland Park, Kansas and other addresses that were local to the Raleigh, North Carolina area. The address for the Overland Park, Kansas office belonged to an elderly couple who had no knowledge of TCT. The other local addresses were either the current or past residences of the project manager. The project manager said the Kansas address belonged to relatives that he used in order to have a local address to obtain equipment from a vendor located in Kansas. He also said he used the name of an acquaintance (instead of his own name) as a contact because he "suspected it was wrong."

Our review of the project manager's personnel file revealed he signed a "staff employee orientation" form confirming he had been advised of the secondary employment disclosure requirement. However, we did not find a completed secondary employment form. The project manager said he had not made NCSU management aware of his secondary employment activities.

⁵ On a credit application found on the computer, TCT indicated annual revenue estimated at \$175,000.

FINDINGS AND RECOMMENDATIONS (CONCLUDED)

The North Carolina State Personnel Manual states:

“The employment responsibilities to the State are primary for any employee working full-time; any other employment in which that person chooses to engage is secondary. An employee shall have approval from the agency head before engaging in any secondary employment. The purpose of this approval procedure is to determine that the secondary employment does not have an adverse effect on the primary employment and does not create a conflict of interest.

It is the responsibility of the employee:

- *To complete a Secondary Employment Form for all employment that is not covered by Dual Employment, and*
- *To update the form annually, as well as to document changes as they occur.”*

NCSU requires its entire faculty and Exempt from State Personnel Act staff to complete a conflict of interest form when hired and update it annually and anytime changes occur to the individual's situation. However, the project manager is an employee subject to the State Personnel Act (SPA) and no such requirement exists for these employees.

SPA employees are required to complete a secondary employment request form so that supervisors can evaluate the secondary employment as it relates to NCSU employment. As part of that evaluation, supervisors are expected to consider possible conflicts of interest with secondary employment. By not completing the secondary employment form, the project manager did not provide NCSU management the opportunity to evaluate whether his private business conflicted with his responsibilities to NCSU.

RECOMMENDATIONS

NCSU management should ensure that all employees have completed a secondary employment form in accordance with State Personnel policies and should annually remind employees of the need to complete the form if there have been any changes. In addition, NCSU should consider requiring SPA employees who have positions involving managerial decision-making, such as contract administration, to complete an additional conflict of interest disclosure.

[This Page Left Blank Intentionally]

RESPONSE FROM NORTH CAROLINA STATE UNIVERSITY

North Carolina State University is a land-grant university and a constituent institution of The University of North Carolina

Office of the Chancellor
Box 7001 / A Holladay Hall
Raleigh, North Carolina 27695-7001

NC STATE UNIVERSITY

919.515.2191 (phone)
919.831.3545 (fax)

August 25, 2006

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

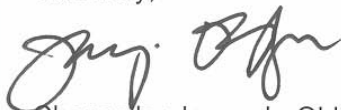
Dear Mr. Merritt:

Attached please find our response to your draft letter dated August 10, 2006 regarding a special review of the Facilities Operations Department at NC State University. Facilities management and our Director of Internal Audit have reviewed the report and recommendations.

All issues identified in your letter have been addressed. Our Internal Audit Division is conducting further review of this matter and will issue a separate audit report upon completion.

Please contact me if you require additional information.

Sincerely,



Chancellor James L. Oblinger

Enclosures: Report response

cc: Ms. Mary Elizabeth Kurz, Vice Chancellor and General Counsel
Mr. Charles Leffler, Vice Chancellor for Finance and Business
Ms. Barbara Carroll, Associate Vice Chancellor for Human Resources
Mr. Kevin MacNaughton, Associate Vice Chancellor for Facilities
Mr. Ernie Murphrey, Associate Vice Chancellor for Financial Services
Mr. Jack Colby, Assistant Vice Chancellor for Facilities Operations
Ms. Ericka F. Kranitz, Director of Internal Audit

**NC State University
Response to Special Review of the Office of State Auditor Report
Facilities Operations Department**

State Auditor Finding:

1. A project manager used his university position to derive a direct benefit for his private business.

State Auditor Recommendations:

NCSU should establish policies and procedures related to construction contracts that require an "audit clause" in the contract that would allow NCSU to review information related to any subcontractors, suppliers or other vendors that may be furnishing equipment or services to the primary contractor. We also recommend NCSU perform periodic comparisons of NCSU employee information and vendor information to determine if an employee is receiving payments from NCSU as a vendor or contractor.

NC State Response:

Currently, all NC State contracts which are bid -- and the state contracts we have with various vendors -- contain the following language:

ACCESS TO PERSONS AND RECORDS: The State Auditor shall have access to persons and records as a result of all contracts or grants entered into by State agencies or political subdivisions in accordance with General Statute 147-64.7.

NC State will add the following language to the above: "Further, the University's Internal Auditor will be provided the same access to persons and records."

Prior to the State Auditor investigation, the Assistant Vice Chancellor for Facilities Operations had transferred the responsibility for administering convenience contracts from the Building Maintenance and Operations unit to the Business Services unit within the Facilities Operations department to segregate the oversight. In addition, effective September 1, 2006, contract awards and payments exceeding \$20,000 will be required to have a higher level of review and approval than the project manager.

Facilities Operations or the Controller's Department will compare our vendor database with that of current employee to identify any potential conflicts of interest based upon the employee's position or outside business interests in companies with which the University does business. Any unusual items will be investigated. In addition, the Facilities Operations Contract Administrator should

regularly analyze the top vendors and the project managers on these accounts to identify any unusual relationships.

State Auditor Finding:

2. The project manager failed to disclose secondary employment to university management.

State Auditor Recommendations:

NCSU management should ensure that all employees have completed a secondary employment form in accordance with State Personnel policies and should annually remind employees of the need to complete the form if there have been any changes. In addition, NCSU should consider requiring SPA employees who have positions involving managerial decision-making, such as contract administration, to complete an additional conflict of interest disclosure.

NC State Response:

The project manager was terminated from the University effective May 23, 2006. NC State University regularly reminds employees of the requirements for secondary employment. For example, the requirement for the annual renewal and a link to the form was noted in the August 2005 and August 2006 Human Resources newsletters, which are distributed to personnel representatives for communication to employees. Facilities Operations will work with Human Resources to evaluate the need to have certain SPA employees in decision-making positions complete an additional conflict of interest disclosure form on an annual basis.

Further, the Facilities Operations department has provided ethics training to all supervisors and will evaluate providing similar training to others in a managerial position and new employees upon hire.

[This Page Left Blank Intentionally]

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647