



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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August 9, 2007

Mr. Lyndo Tippett, Secretary
North Carolina Department of Transportation
1 South Wilmington Street
Raleigh, North Carolina 27611-1501

Dear Secretary Tippett:

We received an allegation through the *State Auditor's Hotline* concerning purchases by the North Carolina Department of Transportation (DOT) Materials and Test Unit (Materials and Test). Allegedly, Materials and Test violated DOT purchasing policies and procedures by purchasing office supplies from a vendor not listed on the state term contract for office supplies and misclassifying data processing equipment as office supplies.

We have completed a review of these allegations. The following findings and recommendations are based on our examination of invoices, accounting data, the state term contract for office supplies, applicable state laws, DOT policies and procedures, and interviews of DOT employees.

Delegation of Purchasing Authority

The Secretary of the North Carolina Department of Administration is authorized to purchase goods and services for the State of North Carolina under North Carolina General Statute § 143-49 (1). North Carolina Administrative Code (01 NCAC 05A.0101) authorizes the delegation of this function to the State Purchasing Officer who manages the Division of Purchase and Contract (P&C) and reports to the Secretary of Administration.

The State Purchasing Officer established a \$25,000 purchasing delegation for DOT purchases of commodities, printing, and services. The DOT Purchasing Officer, in turn, established a \$1,000 purchasing threshold for most DOT departments. All DOT purchasing agents are subject to policies and procedures in the *DOT Purchasing Manual*.

Violation of Procurement Policies for Office Supplies

DOT purchased office supplies from a vendor that was not on the state term contract. We identified 595 purchases¹ from this vendor, totaling \$175,014, between April 1, 2003 and August 15, 2006. \$93,483 (53%) of these purchases originated from Materials and Test.

¹ The term contract for office supplies applies to purchases exceeding \$100 for any single order. Each of the 595 purchases exceeded \$100.

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P&C establishes term contracts for commonly used commodities and services. Term contracts are defined in the North Carolina Administrative Code (01 NCAC 05A.1101) as contracts that consolidate state agency requirements into one agreement and are generally used to establish suppliers and prices for a given commodity, group of commodities, or services without specifying the quantity of commodities involved. By combining commonly used items into one contract, P&C eliminates the need for each agency to independently solicit bids for these commodities and services.

The *DOT Purchasing Manual* states all goods and services covered by term contracts must be purchased in accordance with the instructions of those contracts. The office supplies term contract requires all purchases over \$100 to be purchased from an approved vendor. Therefore, DOT violated state and agency purchasing regulations since office supplies with a value greater than \$100 were purchased from a vendor outside the term contract.

In addition, we found DOT paid more for office supplies than what would have been paid to vendors under the term contract. We selected a random sample of 58 purchase orders from the 595 purchases and compared prices of 124 line-items from these 58 purchase orders. We found 116 (94%) of the 124 line-items were priced higher than comparable line-items from term contract vendors. As a result, the State was charged \$3,680 more than if the office supplies were purchased from term contract vendors. Further, there is no DOT policy that requires documentation and supervisory approval to support exceptions to term contract use.

In response to our inquiry, the Materials and Test supervisor said he did business with this vendor because its ordering process was easy and expedient. He said he was aware the vendor was no longer on the term contract as of 2003, but that use of the term contracts was not emphasized by DOT prior to 2006. The supervisor admitted knowing the president, treasurer and two other employees from this vendor. He also indicated he had a social relationship with an employee from this vendor. We believe these relationships may create, at a minimum, the appearance of a conflict of interest.

We interviewed nine other DOT purchasing agents to determine why they did not always use the state term contract for office supplies. Some agents said items from these vendors were not always available or did not meet user requirements. One agent said she used a Historically Underutilized Business (HUB) and that DOT promoted such vendors. Another agent said she used a vendor that provided quick delivery. Several agents said they used other vendors in emergencies. Several agents indicated DOT had not emphasized term contract use prior to 2006.

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Violation of Procurement Policies for Information Technology

During our review, we discovered three printers purchased in early 2004 that Materials and Test improperly recorded as office supplies. The DOT Fixed Asset Policy states all data processing equipment will be recorded on the Fixed Asset System regardless of its cost for purposes of maintaining inventory. Thus, Materials and Test violated the DOT Fixed Asset Systems policy related to classifying and inventorying data processing equipment. In addition, the Materials and Test supervisor said he could not locate one of the three printers and was not aware printers should be recorded as data processing equipment.

There was no documentation to indicate the supervisor's approval prior to the printer purchases or approval of the transaction. Supervisory approval provides better control over the authorization and the recording of purchase transactions. The supervisor indicated he was aware of the printer purchases but had assigned responsibility for the purchase and recording of the three printers to an employee who reported to him. One of these printers was ordered, received, and recorded by the same employee.

Recommendations

DOT should comply with regulations regarding the mandatory use of term contract vendors. Written justification and supervisory approval should be required for any exception to term contract use. DOT Purchasing Agents should maintain written justification for exceptions to term contract use. If exceptions occur because the term contract vendor does not comply with contract obligations or fails to meet user needs, the DOT agent should notify the P&C contract administrator using P&C's vendor complaint form.

Printers should be recorded as data processing equipment to ensure accountability and inclusion in equipment inventory. Supervisory approvals should be documented for all purchase transactions. These approvals should be required prior to making purchase commitments and upon receipt of goods prior to payment. These approvals validate business need and proper classification. In addition, DOT management should ensure the purchasing and receiving functions within a unit are performed by different individuals.

The *DOT Purchasing Manual* should be updated to reflect any policy amendments. The ethics section of the DOT Purchasing Manual should provide guidance regarding relationships that create the appearance of impropriety or conflicts of interest. In addition, the DOT Purchasing Office should provide training updates to all DOT purchasing agents on an annual basis.

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Please provide your written response to these findings and recommendations, including corrective actions taken or planned, by August 23, 2007. In accordance with General Statute § 147.64.6 (c)(12), the Governor, the Attorney General, 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 employees of the Department of Transportation.

Sincerely,

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

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

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



STATE OF NORTH CAROLINA
DEPARTMENT OF TRANSPORTATION

MICHAEL F. EASLEY
GOVERNOR

1501 MAIL SERVICE CENTER, RALEIGH, N.C. 27699-1501

LYNDO TIPPETT
SECRETARY

August 23, 2007

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

Dear Auditor Merritt:

This is in response to the allegation through the *State Auditor's Hotline* concerning purchases by the North Carolina Department of Transportation (NCDOT) Materials and Test Unit.

Members of your staff met with representatives of the Department and also provided us a confidential draft of the finding and recommendations dated August 9, 2007. I have reviewed each of the recommendations below, and offer my responses:

Recommendation:

NCDOT should comply with regulations regarding the mandatory use of term contract vendors. Written justification and supervisory approval should be required for any exception to term contract use. NCDOT Purchasing Agents should maintain written justification for exceptions to term contract use. If exceptions occur because the term contract vendor does not comply with contract obligations or fails to meet user needs, the NCDOT agent should notify the P&C contract administrator using P&C's vendor complaint form.

Response:

I am in agreement with the recommendation requiring the use of term contract vendors and documenting reasons why other vendors need to be used.

Recommendation:

Printers should be recorded as data processing equipment to ensure accountability and inclusion in equipment inventory. Supervisory approvals should be documented for all purchase transactions. These approvals should be required

prior to making purchase commitments and upon receipt of goods prior to payment. These approvals validate business need and proper classification. In addition, NCDOT management should ensure the purchasing and receiving functions within a unit are performed by different individuals.

Response:

I agree with the recommendation to record printers as data processing equipment and to have supervisory oversight. The recommendation to have different individuals handle purchasing and receiving functions within a unit is an excellent control feature and will be followed. Any exceptions would be in some extreme cases resulting from staffing issues and volume of purchases. Personnel conferences will be conducted with employees involved in the subject purchases. The Department's Ethics Policy and establishment of individual development plans will also be a part of this review.

Recommendation:

The *NCDOT Purchasing Manual* should be updated to reflect any policy amendments. The ethics section of the NCDOT Purchasing Manual should provide guidance regarding relationships that create the appearance of impropriety or conflicts of interest. In addition, the NCDOT Purchasing Office should provide training updates to all NCDOT purchasing agents on an annual basis.

Response:

I agree that the Purchasing Manual should continue to be kept current, and I have always been a strong proponent of training at all levels. Last year the Department's Purchasing Section provided training to all the Divisions regarding purchasing fundamentals. I will request that they fortify the purchasing training that has been completed to date and offer this class on an annual or semi-annual basis throughout the Department. Furthermore, we will provide a link to the Department's Ethics Policy in Section 4.0 of the Purchasing Manual and also review Section 4.0 to ascertain if additional ethics emphasis should be added.

Thank you for the opportunity to respond to the recommendations in the August 9, 2007, letter. I appreciate the work of the Office of the State Auditor to help the Department improve its policies and procedures as well as increase savings.

Sincerely,



Lyndo Tippett

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LT/jbd

cc: Dan DeVane, Chief Deputy Secretary
Bill Rosser, PE, State Highway Administrator
Steve Varnedoe, PE, Chief Engineer - Operations
Jon Nance, PE, Director of Field Operations
Cecil Jones, PE, State Materials Engineer
Jack Cowsert, PE, State Materials Quality Engineer
Mark Foster, CFO
Donnie Thorne, Director of Purchasing