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**South Carolina
Division of General Services**

PROCUREMENT AUDIT AND CERTIFICATION

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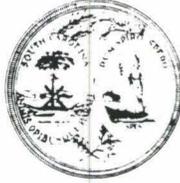
S.C. DEPARTMENT OF MENTAL RETARDATION

AGENCY

MAY 17, 1983

DATE

STATE OF SOUTH CAROLINA
BUDGET AND CONTROL BOARD
DIVISION OF GENERAL SERVICES
800 DUTCH SQUARE BLVD., SUITE 150
COLUMBIA, S. C. 29210
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WILLIAM T. PUTNAM
EXECUTIVE DIRECTOR

MATERIALS MANAGEMENT

May 17, 1983

Mr. Tony R. Ellis
Acting Deputy Director
Division of General Services
300 Gervais Street
Columbia, South Carolina 29201

Dear Tony:

Attached is the final Department of Mental Retardation audit report and recommendations made by the Materials Management Office. Since no certification request above the \$2,500.00 allowed by law remains to be considered by the Budget and Control Board, I recommend that this report be presented to them for the purpose of information.

Sincerely,

A handwritten signature in cursive script that reads "Richard J. Campbell".

Richard J. Campbell
Acting Materials Management
Officer

RJC:khl

Attachment 1

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INTRODUCTION

The Audit and Certification Section conducted an examination of the internal procurement operating procedures and policies and related manual of the South Carolina Department of Mental Retardation.

Our on-site review was conducted April 7, 1982 through June 1, 1982.

Our examination was made under the authority as described in Section 11-35-1230(1) of the South Carolina Consolidated Procurement Code and Section 19-445.2020 of the accompanying regulations.

PURPOSE

Our examination was directed principally to determine whether, in all material respects, the procurement system's internal controls were adequate and the procurement procedures, as outlined in the Internal Procurement Operating Procedures Manual, were in compliance with the South Carolina Consolidated Procurement Code and its ensuing regulations.

Additionally, our work was directed toward assisting the agency in promoting the underlying purposes and policies of the Code as outlined in Section 11-35-20, which include:

- (1) to ensure the fair and equitable treatment of all persons who deal with the procurement system of this State;
- (2) to provide increased economy in state procurement activities and to maximize to the fullest extent practicable the purchasing values of funds of the State;
- (3) to provide safeguards for the maintenance of a procurement system of quality and integrity with clearly defined rules for ethical behavior on the part of all persons engaged in the public procurement process.

BACKGROUND

Section 11-35-1210 of the South Carolina Consolidated Procurement Code states:

The Budget and Control Board may assign differential dollar limits below which individual governmental bodies may make direct procurements not under term contracts. The materials management office shall review the respective governmental body's internal procurement operation, shall certify in writing that it is consistent with the provisions of this code and the ensuing regulations, and recommend to the board those dollar limits for the respective governmental body's procurement not under term contract.

On March 4, 1982, the South Carolina Department of Mental Retardation requested certification to bid pharmaceutical drugs on an annual basis. Approval was granted by the Materials Management Office on March 10, 1982 for an interim one year contract. On April 7, 1982, the South Carolina Department of Mental Retardation requested additional certification as follows:

Consultant Services.

- a. Professional Services - \$50,000
- b. Employment Services - \$50,000
- c. Architectural/Engineering Service - \$12,000 per contract or \$36,000 in multiple contracts over two year period

Construction and Related Professional Services.

As defined in the SCDMR Procurement Manual:

- a. Repair Services - \$50,000
- b. Renovation - \$10,000
- c. Construction - \$10,000

As a result of these requests, we began an audit of the procurement system on April 7, 1982.

SCOPE

Our examination encompassed a detailed analysis of the internal procurement operating procedures of the South Carolina Department of Mental Retardation and the related policies and procedures manual to the extent we deemed necessary to formulate an opinion on the adequacy of the system to properly handle procurement transactions up to the requested certification limits.

The Audit and Certification team of the Materials Management Office statistically selected random samples for the period July 31, 1981 - April 28, 1982, of procurement transactions for compliance testing and performed other auditing procedures that we considered necessary in the circumstances to formulate this opinion. As specified in the Consolidated Procurement Code and related regulations, our review of the system included, but was not limited to, the following areas:

- (1) adherence to provisions of the South Carolina Consolidated Procurement Code and ensuing regulations;
- (2) procurement staff and training;
- (3) adequate audit trails and purchase order register;
- (4) evidences of competition;
- (5) small purchase provisions and purchase order confirmations;
- (6) emergency and sole source procurements;
- (7) source selections;
- (8) file documentation of procurements;
- (9) reporting of Fiscal Accountability Act;
- (10) warehousing, inventory and disposition of surplus property; and
- (11) economy and efficiency of the procurement process.

SUMMARY OF AUDIT FINDINGS

Our examination of the procurement system of the South Carolina Department of Mental Retardation produced findings and recommendations in the following areas:

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I. <u>Authority, Responsibility and Organization</u>	11
A. Administrative Control of Procurement System	11
The South Carolina Department of Mental Retardation is a highly decentralized agency, both administratively and programmatically; therefore, procurement procedures are not standardized on an agency wide basis making Central Office evaluation of performance less effective.	
B. Internal Requisition Procedures	13
Central Office has no initiating requisition procedures and the other regions' procedures are not standard.	
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Purchasing and Supply Sections at all regions do not have effective control over all purchase orders issued.	

- E. Small Order Handling Techniques 18
- The South Carolina Department of Mental Retardation should consider a small order purchase option since a large volume of transactions are less than \$100.
- F. Changes to Purchase Orders 20
- The increase or decrease of a purchase order quantity or amount is not under the control of Purchasing since no formal change order system is in place.
- G. Timely Payment of Invoices 22
- Our examination revealed that due to untimely processing, the Department of Mental Retardation lost discounts; several vouchers required in excess of sixty days for payment.
- H. Documentation in Central Office's Voucher Package 24
- Supporting documents required for payment at Central Office do not provide all necessary information for effective central administrative review.
- I. Cost Study of Centralized versus Decentralized Procurement 27
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As a result of a change in agency policy, the Department of Mental Retardation has a large surplus inventory of clothing that it has not declared as such to the Materials Management Office.

V. Fiscal Accountability Act

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The Department of Mental Retardation is not in compliance with the Fiscal Accountability Act quarterly reporting requirements.

VI. Personal Needs Funds

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A. Contributions by Department of Mental Retardation to Personal Needs Fund and Purchases on Behalf of Clients from Personal Needs Fund

45

The Department of Mental Retardation should perform an administrative review of contributions to clients for personal needs and purchases on behalf of clients from these funds to ensure compliance with all participating governmental regulations.

B. Co-Mingling of Purchases from Personal Needs Funds with State Funded Purchases

47

The Department of Mental Retardation purchases personal items for its client population from appropriated funds when there are sufficient client funds available to pay for the goods.

VII. Internal Audit

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There is a need for greater involvement in the procurement process by the Department of Mental Retardation's internal audit staff.

VIII. Review of Department of Mental Retardation's Procurement Manual

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Our examination has revealed that additional policy and procedure documentation is necessary in the Procurement Manual before approval can be granted for the certification limits requested.

RESULTS OF EXAMINATION

I. Authority, Responsibility and Organization

A. Administrative Control of Procurement System

The South Carolina Department of Mental Retardation is a highly decentralized agency, both administratively and programmatically. It is, in essence, divided into five distinct entities; Central Office, Piedmont, Midlands, Coastal and Pee Dee.

The Deputy Commissioner of Administration at Central Office is charged with the agency wide responsibility for the procurement cycle. This office further delegates the responsibility for (1) ensuring adherence to the policies as stated in the Procurement Manual to the following Central Office management personnel:

Director of Supply & Support Services	- Goods & Services
Director of Engineering & Planning	- Construction/Renovation
Director of Personnel	- Consultants
Director of Data Processing	- Information Technology

Additionally, the Deputy Commissioner delegates to the Regional Superintendents the (2) responsibility of implementing procedures in their respective regions that are in accordance with the policies as stated in the Procurement Manual.

In summary, the Deputy Commissioner of Administration has delegated his procedural authority to the regions, but has maintained his control and compliance (policy) authority at Central Office.

Our examination revealed little standardization, agency wide, in procurement procedures. Each region had in place a system somewhat different

from the others. Most of the similarity that was detected between regions appeared to be dictated by the function or customary practice. We found ranges within regions from the very well run, sophisticated procurement system at Central Warehouse, to the regional procurement department as a simple clerical function, rubber stamping and processing requisitions with very little review.

Organizationally, this is in keeping with the intent of the Commission, as expressed in the Procurement Manual, if the range of procedures are in compliance.

On the other hand, our examination detected weak evaluation procedures to enable Central Office to exercise its responsibility to ensure compliance to the Procurement Manual and the Code.

Due to Central Office's basic failure to exercise its control and compliance oversight responsibility, the Department of Mental Retardation is out of compliance with the Procurement Code as subsequent comments will indicate. This is not the intent of the Commission, as expressed in the Procurement Manual.

We, therefore, recommend that the Deputy Commissioner of Administration and his Directors, with the assistance of the Internal Audit staff, establish and implement standards and procedures that will enable Central Office management to evaluate regional performance to ensure compliance with the Department of Mental Retardation policies and state laws and regulations. Specific indicators of performance are pointed out in subsequent comments and should be incorporated in an agency wide system of internal controls for the procurement activity.

B. Internal Requisition Procedures

Our analysis of the procurement system at Central Office revealed that no initiating requisitions are being used for purchases. During our field audits of the regional centers, we noted that requisitions are being used to communicate departmental needs to the procurement section. However, there is no formal standardized initiating document being utilized by the different regions, whereas the purchase order document is the same format at all regions.

Good internal control dictates that an initiating document, such as a requisition, be included in the system for all procurements. This document when fully completed and signed by the preparer, with an approval of the section or fund manager, serves as one of the supporting documents for the appropriate officers to use in verifying and approving payment.

The Internal Procedures Manual does not address a requisition procedure for any region including Central Office. The absence of this procedure reduces internal control, complicates the audit trail and hinders evaluation of performance.

We recommend that the Department of Mental Retardation implement the following steps to strengthen their internal requisition procedure:

- (1) Central Office should adopt a requisition format for procurements which will serve as a supporting document to the transaction.
- (2) A policy should be developed whereby all requisitioning documents should be the same format throughout the agency, thus facilitating processing.
- (3) The procurement manual should be updated to detail the requisition procedure and policy applicable

to all regions. This policy should specifically include authorization procedures for each purchase request to be reviewed at the appropriate level.

C. Receiving and Shipping Procedures

During our examination of the procurement documents throughout the Department of Mental Retardation, it was noted that the receiving and delivery routines vary greatly between the regions. These routines range from a modern and sophisticated system to ones which are inadequate and lack sufficient checks and balances. Our review revealed some deficiencies which we felt were significant and should be corrected in order to maximize the efficiency of the materials handling portion of procurement. These deficiencies include:

- (1) Incoming shipments of items being received and acknowledged by the purchasing agent indicating a weak separation of duties.
- (2) The receiving part of the purchase order not being signed by the warehouse personnel when the goods arrive at the dock.
- (3) The receiving copy of the purchase order revealing the quantity and prices of the incoming shipments to the warehouseman which does not force an independent count of goods.
- (4) The internal procurement procedures manual does not include a receiving and delivery procedure for the regions.

Good internal control in the receiving and delivery functions of the procurement system dictates that procedures be developed which ensure

accuracy, and sufficient checks and balances such as:

- (1) Incoming shipments being verified by individuals independent of the ordering department and with no knowledge of the quantity being shipped.
- (2) Receiving reports being signed by warehousemen and matched by Accounts Payable to the vendor's invoice.
- (3) Proper procedures clearly outlined in the Internal Procedures Manual outlining the personnel functions and responsibilities.

We feel that the rapid expansion of the regional campuses over the past years, coupled with a lack of written uniform procedures for them to adhere to in the shipping and receiving areas, has decreased their overall effectiveness.

Weak receiving and delivery routines can result in inventory imbalances, improper damage claims being filed and increased vehicle and handling costs. Overall, the productivity and effectiveness of the entire procurement function is hampered with the subsequent devaluation of the purchasing dollar and increased cost of operation.

We recommend that the following steps be implemented to the degree necessary at each center, so as to increase the effectiveness of the receiving and delivery functions throughout the agency:

- (1) Re-evaluate existing procedures for inclusion in the Internal Procurement Procedures Manual. They should include but not be limited to:
 - (a) Damage Claim Procedures

- (b) Ensuring separation of duties between ordering and receiving units.

These written procedures must be clearly introduced to warehousemen through implementation meetings in order to ensure compliance and understanding.

- (2) Study the possibility of revamping the receiving copy of the purchase order to make it a more effective document. Some considerations should be:

- (a) Standardizing the location of the signature of the receiving clerk on the document.
- (b) Eliminating the prices and quantities so the individual receiving the items can make independent judgment as to quantity. Prices are not relevant to the receiving function.

D. Procurement's Control Over Purchase Orders

Our examination at Pee Dee and Coastal revealed that two purchase order registers were being maintained. One was being used by the Procurement Department, and the other was located in the Accounts Payable Department. Purchase orders are being issued and used by Accounts Payable as encumbrance vehicles for monthly charges on items such as:

- (1) P. O. - 02261-2 - Prescription drugs
- (2) P. O. - 02116-2 - Household supplies

- (3) P. O. - 01824-2 - Transportation charge for students
- (4) P. O. - 02134-2 - Pharmacy consultant monthly fees

Good internal control dictates that the purchasing department be responsible for all procurements and control of all purchase orders. If the purchase orders are to be used as an office mechanism for the payment of bills, then they should be approved by the purchasing agent.

The departments at this time lack the internal system to pay the above types of invoices and resort to using purchase order numbers to get the checks paid from the computer.

We recommend one of the following options be implemented to meet the needs of Accounts Payable and the Procurement Division's requirements for good internal control:

- (1) OPTION I - Maintain the procurement division as the responsible agent for the final approval of all purchase orders issued, regardless of the item being paid. Implementing proper procedures for blanket agreements and purchase orders will eliminate much of the need for monthly purchase orders through referencing the initial order number. This procedural system, established in accordance with the Consolidated Procurement Code and regulations, should lend itself to increasing efficiency and cost effectiveness overall.
- (2) OPTION II - Implement a small order handling system as outlined in our next comment, I-E.

E. Small Order Handling Techniques

By utilizing the data supplied by the Fiscal Accountability Act, our analysis revealed that in at least three regional centers of the Department of Mental Retardation an excessive number of purchase orders were being issued for less than \$100. Specifically, the computer run covered the fiscal period July 1, 1982 through April 28, 1982, and showed an average of 50% of all the purchase orders issued were less than \$100 but accounted for only 10% or less of all expenditures.

The National Association of Educational Buyers' handbook on "Small Purchase Procedures" identifies a number of universities using a system to control small transactions effectively. Whether a system is applied at a school or state agency, adequate control of small transactions reduces the cost of processing purchase orders and results in a measurable cost savings to the procurement section, effectively increasing economy and efficiency.

There is at this time very little attempt being made to control the extensive manual processing of small requests, although management seems to be aware of the necessity for small purchase procedures. An attempt is being made at some reduction in paper flow through the use of blanket purchase orders, although this effort is limited in scope.

Procurement and accounting personnel continue to be inundated with purchase order processing thereby continuing to negate the effectiveness of their particular job functions.

The average cost of processing a purchase order has been found to be approximately \$25. During the fiscal period analyzed at the three regional centers, the operating costs of processing 2,322 small purchase orders (50% of total purchase orders, 4,645) with a dollar value of \$89,643 at a unit cost of processing of \$25 would be \$58,050. The expertise of the buyers and

their production time can be more effectively directed towards maximizing the return for dollars spent if the number of purchase orders processed can be reduced in quantity.

In order to improve the procedural methods of handling small transactions, thereby improving cost savings throughout the procurement system at the Department of Mental Retardation, we recommend the following options for consideration:

OPTION 1 - Implement a study of procurement's small order handling techniques to determine if a limited purchase order system would improve the cost savings in the procurement section of the Department of Mental Retardation. Restrict these small purchases to certain dollar limits, granting properly authorized members of a region authority to order directly from vendors. Further limits could be imposed by directly limiting the applicable commodities which could be bought.

Accounts Payable clerks could use limited purchase orders to pay utility, postage and other monthly charges exempted from code compliance instead of using dual purchase order registers or fabricating purchase order numbers to initiate the check-write through the computer.

We feel that adequate monitoring should be established with the Director of the Procurement Division to ensure that departments are not circumventing the law. Also, an annual review of the system to re-determine the dollar limit and adjust it for inflation and/or other factors would be appropriate.

OPTION 2 - Expansion of the current blanket purchase order system and/or blanket agreements to reduce the number of purchase orders being processed by procurement and accounts payable. These could include annual blanket orders for utilities, copier usage, and service contracts, thus eliminating "dummy" purchase orders as a buying mechanism.

This expansion should be implemented and developed following the guidelines of blanket agreements outlined in the permanent regulations.

Predicated on the Department of Mental Retardation's ability to institute adequate internal controls, we recommend either option, or a combination thereof, as a plausible method of meeting the agency needs in an efficient and cost effective manner.

F. Changes to Purchase Orders

Purchase orders are being increased or decreased without using official "change orders". In some cases the buyer approves the change by annotating the purchase order. In other cases a user department may initiate the changes without notifying the Procurement Department. Often the Procurement Department is the last to know and their authorization extends only to an after-the-fact approval when they are contacted by Accounts Payable.

Good internal controls dictate that a change order should be issued if the content of an order materially changes after its issuance but prior to completion.

The N.A.E.B. (National Association of Educational Buyers) states in its guide to small order handling that:

A material change is defined as an alteration in the scope of the contract which affects delivery dates or destinations of items to be delivered, affects the quantity of items ordered and/or their unit price, or changes any other terms which are pertinent to the original purchase order.

There are some changes which can only be determined after the fact such as "installation charges" and "overruns". However, the majority of price order changes are known prior to delivery, i.e., freight charges, etc. A formal change order system accomplishes several objectives:

- (1) Control of price deviations by the purchasing agent thereby centralizing the authorization function.
- (2) Preventing vendors from making unauthorized price changes in purchase orders which are issued and approved at a specific price.
- (3) Monitoring using department requests to authorize quantity changes to vendors.

It is the tendency of the procurement departments to make changes without a "change order" to reduce paper flow. This is especially applicable when making small or minor changes. However, a formal change order officially advises all parties concerned of a change. Without the document, a dilution of internal control occurs.

We recommend the following steps be implemented to strengthen internal control over purchase order changes within the procurement process:

- (1) A formal written change order procedure be inserted in the Department of Mental Retardation Internal Procedures Manual.
- (2) Mandate that final approval authority remain with the purchasing director, thus maintaining control over all purchase order changes.
- (3) Ensure that purchasing agents are confirming prices before issuing purchase orders, so as to reduce the number of changes occurring.
- (4) Educate the departments to the extent that request for changes in prices and quantities will not be processed if there is no prior approval by the purchasing director.

G. Timely Payment of Invoices

Our examination of 114 vouchers determined the following:

	<u>Percentage of Transactions Tested</u>
(1) Four vouchers were paid untimely and the cash discounts were lost	3.51%
(2) Two vouchers required in excess of sixty days from the invoice date to the payment date for processing	<u>1.75%</u>
	5.26%

Section 11-35-20(f) of the Consolidated Procurement Code states as one of its purposes:

to provide increased economy in state procurements and to maximize to the fullest extent practicable the purchasing values of funds of the State.

Additionally, Section 17, as amended, of the Code states:

(A) Beginning January 1, 1983, all vouchers for payment of purchases of goods or services shall be delivered to the Comptroller General's office within thirty work days from receipt of the goods or services whichever is received later by the agency. After the thirtieth work day, the Comptroller General shall levy an amount not to exceed fifteen percent per annum from the funds available to the agency, such amount to be applied to the unpaid balance to be remitted to the vendor.

(B) All agencies and institutions of the State are required to comply with the provisions of this section. Beginning July 1, 1983, the Department of Mental Health, the Department of Mental Retardation, the Department of Corrections, the Interagency Council on Public Transportation and the Sea Grant Consortium shall process all payments for goods or services through the Comptroller's Office. Only the lump sum institutions of higher education and the Department of Highways and Public Transportation shall be responsible for the payment of all goods or services within thirty work days after the receipt of the goods or services, whichever is received later and shall pay an amount not to exceed fifteen percent per annum on any unpaid balance which exceeds the thirty work day period.

(C) The Comptroller General shall issue written instructions to the agencies to carry out the intent of this section. All offices, institutions, and agencies of state government shall fully cooperate with the Comptroller General in the implementation of this section.

(D) The thirty day period shall not begin until the agency, whether or not the agency processes vouchers through the Comptroller General, certifies its satisfaction with the received goods or services.

As a result of a weak control effort by Accounts Payable and an untimely processing function at the Regional Level, the South Carolina Department of

Mental Retardation expended funds in an unnecessary manner by way of discounts lost.

Additionally, if cash discounts were considered as cost reductions in the source selection process, the integrity of the competitive system is undermined if, after the fact, such discounts are lost.

While we did not seek to determine the extent of funds unnecessarily expended due to this finding, we have documented that 5.26% of transactions tested indicate weak control.

We, therefore, recommend that the user departments be notified of the importance of processing the necessary reports within the necessary time frame to facilitate prompt payment with full advantage to the South Carolina Department of Mental Retardation and the State.

H. Documentation in Central Office's Voucher Package

Central Office makes all disbursements for the Department of Mental Retardation. Our examination of the voucher packets at Central Office revealed that the basic requirements for payment were as follows:

- (1) The original invoice
- (2) A voucher input sheet establishing, by authorized initials, the following pertinent information:
 - a. Signed receiving report
 - b. Purchase order matches invoice
 - c. Various clerical functions, extension checks, etc.
 - d. Payment approved

The original documentation, including the requisition and quote forms, supporting the voucher input sheet initials is maintained in the regional purchasing and supply files. A copy of the input sheet and invoice is

maintained in the regional accounts payable files.

One of the control procedures at Central Office is a review by the Deputy Commissioner of Administration of all cash disbursements in excess of \$400. This means he looks at the original invoice and the voucher input sheet. From the review he is able to determine the following pertinent information:

- (1) Vendor, commodity, prices, amount, etc.
- (2) Funding source, region, program, service, cost center and budget class affected by the expenditure.
- (3) Relying on the initials he can assume all the above are correct and the commodities are received by the appropriate end user and are reasonable.

Those pertinent control points he cannot ascertain are as follows:

- (1) Who generated the requisition?
- (2) Was it properly approved by the program administrator or other appropriate official for fund availability and reasonableness?
- (3) Were the goods actually received by supply and the end user?
- (4) Was the purchase order properly processed and signed or was it confirmed after the fact?
- (5) Were any changes between purchase order and invoice properly authorized?
- (6) Do the documents support the proper separation of duties to prevent collusion or other

circumvention of the policies and procedures
of the Department of Mental Retardation?

As a result of Central Office's inability to determine answers to these critical concern factors, they are unable to ensure adherence to the policies set forth in the Procurement Manual and the Procurement Code.

We, therefore, recommend the following options:

OPTION I:

The voucher package at Central Office contain the following documentation:

- (A) Original invoice.
- (B) Copy of the requisition properly authorized by requestor, program administrator or other appropriate official.
- (C) Copy of the purchase order and any change orders.
- (D) Copy of the receiving document properly signed by the person initially receiving the commodity.
- (E) Documentation verifying delivery to end user. Presently the purchase order or the requisition is used as a delivery slip, properly signed or initialed for this function. Therefore, no additional form would be necessary.
- (F) The voucher input sheet.

We see little additional cost or delay in processing these documents in this fashion. However, we feel the increased benefits in internal control and evaluation

potential supplied to Central Office management would improve their effectiveness in accomplishing their stated goals.

or

OPTION II:

If the Central Office management chooses to delegate its responsibility for ensuring adherence to the Procurement Manual to the Regional Level, we recommend that this be reflected on page 2-1 of the Department's Procurement Manual.

In exercising this option, Central Office management should consider the risk involved in the delegation of such authority against the benefits derived therefrom.

Also, Internal Audit should frequently test the region files for compliance.

I. Cost Study of Centralized versus Decentralized Procurement

The South Carolina Department of Mental Retardation's normalization approach to the delivery of services to clients is highly regarded by health care professionals nationwide. Financially, the goal is to expend the funds at the level that promotes normalization as much as possible. The method used to achieve the Department of Mental Retardation's overall goal would naturally resist an expensive, distant, intrusive Central Office role.

However, we feel management must constantly evaluate the effectiveness and efficiency of the procurement activity in this context and weigh

the cost against the benefits.

We believe the following questions are relevant to Procurement's role in the Department of Mental Retardation's goal of affording each of its clients the opportunity to reach maximum mental, physical, and social potential in a setting as near normal as possible:

- (1) In what ways does delegating to the Region's "line" authority over purchasing and supply enhance the Department of Mental Retardation's goals?
- (2) In what ways would standardization of purchasing and supply procedures agency wide deter the Department of Mental Retardation from its goals? Would it affect the region's ability to respond to the unique needs of its client population?
- (3) What is the cost of a decentralized procurement system compared to that of centralized?
- (4) If the cost of the decentralized procurement system is greater than a centralized system, are the benefits derived therefrom worth it? Or could the funds saved be used more effectively in other services to enrich its client population?

We, therefore, recommend that the Commission authorize the Internal Audit staff to develop a plan to study the procurement activity's role in the goals of the Department of Mental Retardation in order to enable the Department of Mental Retardation to make the most cost effective decision in the delivery of this support service.

II. Code Compliance - General

A. Procurements out of Compliance

During our review of 114 transaction samples throughout the centers of the Department of Mental Retardation in the areas of Goods and Services, Information Technology and Consultants, we determined that a number of procurements in excess of \$500 were not made in compliance with the Consolidated Procurement Code and the permanent regulations.

<u>ITEM OR PURCHASE ORDER</u>	<u>AMOUNT</u>
(1) Binder Folders	\$ 809.00
(2) Uniforms	747.60
(3) Pottery Seminar Consultant	550.00
(4) Client Transportation Service	641.75
(5) Dumpsters	2,100.00
(6) Garbage Pickup Service	849.75
(7) Consultant Speech Therapist	600.00

These items were procured without evidence of any competition and no documentation was made that the procurements were to the advantage of the State, price and other factors considered, including the administrative cost of the purchase.

Section 19-445.2100, Subsection B, states in part:

Purchases from \$500.01 to \$1499.99. Solicitations of verbal or written quotes from two qualified sources of supply shall be made and documented that the procurement is to the advantage of the State, price and other factors considered, including the administrative cost of the purchase. Such documentation shall be attached to the requisition.

Additionally:

Purchases from \$1500.00 to \$2499.99. Solicitations of written quotations from three qualified sources of supply shall be made and documented that the procurement is to the advantage of the State, price and other factors considered, including the administrative cost of the purchase. Such documentation shall be attached to the purchase requisition. When prices are solicited by telephone, the vendors shall be requested to furnish written evidence of their quotation.

Those items which might have been classified as Sole Source Procurements were not documented as such, nor processed in accordance with the code regulations.

These procurements of commodities and services without competition and proper approvals have resulted in the Department of Mental Retardation being out of compliance with the requirements of the Procurement Code.

Our review of the Internal Procedures Manual determined that policies and procedures are in writing to procure these services according to the requirements of the Code. We recommend an immediate implementation of these and other written procedures.

B. Blanket Purchase Agreements

Our review of the purchase orders at the regional centers of the Department of Mental Retardation has revealed that local purchase agreements for small procurements with local vendors are not in compliance with the State Procurement Regulations or the South Carolina Department of Mental Retardation's Internal Procurement Manual. These procurements provide for auto parts, food and produce, electrical supplies, etc.

The State Procurement Regulations as well as the South Carolina Department of Mental Retardation's Procurement Manual are very explicit in their procedures for establishing local blanket agreements. This criteria is located in Section

19-445.2100, Subsection C, and states in part:

...Blanket purchase agreements are designed to reduce administrative costs in accomplishing small purchases by eliminating the need for issuing individual purchase documents.

Additionally:

...Blanket purchase agreements shall contain the following provisions:

- (a) Description of agreement...
- (b) Extent of obligation...
- (c) Notice of individuals authorized to place calls and dollar limitations...
- (d) Delivery tickets...
- (e) Invoices....

Subsection D states in part:

...Calls against blanket purchase agreements should be placed after prices are obtained. When concurrent agreements for similar items are in effect, calls should be equitably distributed. In those instances where there is an insufficient number of BPAs for any given class of supplies or services to assure adequate competition, the individual placing the order shall solicit quotations from other sources.

The Consolidated Procurement Code and its ensuing regulations were not in effect until July 30, 1981. This factor combined with the Department of Mental Retardation's Procedures Manual also not being in place until December 1981 has resulted in improper blanket purchase agreements being established. These blanket purchase agreements are out of compliance with the permanent regulations.

We recommend that all future procurements using blanket purchase agreements be in accordance with Subsection C, D, E of the permanent regulations and the corresponding section of the Department of Mental Retardation Internal Procurement Manual.

C. Sole Source Determinations

Our review of the sole source determination files has revealed that several sole source procurement determinations have been improperly authorized by the Regional Purchasing and Supply managers, or not completed at all.

- (1) P.O. 04-02-0477-82 for wheelchairs;
- (2) P.O. 04-01-1387-82 for wheelchair;
- (3) P.O. 04-04-1428-82 for side rails;
- (4) P.O. 06-09-02351-2 for smoke alarm repair.

The Consolidated Procurement Code in Section 11-35-1560, Sole Source Procurement, states in part:

A contract may be awarded...without competition when, under regulations promulgated by the board, the chief procurement officer, the head of a purchasing agency, or a designee of either officer above the level of the procurement officer determines in writing that there is only one source for the required supply, service or construction item.

Procurement officials are not familiar enough with the specific details of Section 11-35-1560 and its corresponding section in the regulations.

We recommend that the following be implemented at the regional center level with purchasing managers:

- (1) Completion of the training manual on the Consolidated Procurement Code which is issued by the Materials Management Office.
- (2) Structured course in familiarization with the Code and its regulations.
- (3) Familiarization by purchasing personnel with the Department of Mental Retardation Internal

Procedures Manual and the authorization procedures for sole source procurements.

D. Trade-In Sales

From our review of quarterly trade-in sales and approval from the Materials Management Office, we have ascertained that trade-in sales exceeding \$500 are being processed without proper prior authority.

Permanent Regulation 19-445.2150 in Subsection E - Trade-In Sales states in part:

When the trade-in value exceeds five hundred dollars (\$500.00), the governmental body shall refer the matter to the Materials Management Officer for disposition...or for submission to the Board for consideration....

The failure to get the proper approval for trade-in sales stems in part from confusion by the agency as to exactly what constitutes an item classified in this category. The Code does not make exceptions to any commodity, and thus it is specific with regard to reporting all trade-ins. The responsible officials are not interpreting the Code and its regulations accurately, thus placing the agency in a non-compliance position.

We recommend that the responsible officials become more familiar with the Code and its ensuing regulations so that trade-in sales are properly approved by the Materials Management Officer.

E. Construction

Our examination revealed that the South Carolina Department of Mental Retardation's construction procurement methodology neglected to document

in the construction files a decision supporting the procurement of basic equipment under the prime contract.

On PIP #J16-036, the South Carolina Department of Mental Retardation entered a change order and E-11 that reflected a decision to procure basic equipment under the prime contract rather than directly from the distributor as originally planned. This decision was made approximately six months after the original construction contract was executed.

Per the original estimate on the E-11 the anticipated cost of this equipment was \$50,000 at design phase. Due to the delay caused by a statewide freeze on bonds, the cost increased to \$65,000 at the time of procurement. By entering a change order, the prime contractor made the purchase as follows:

Cost of Equipment per Distributor	\$65,000.00
Prime Contractor's Overhead	<u>7%</u>
Additional Cost	\$ 4,550.00
Per Contractor Total Cost added to	
Contract	\$69,550.00
Architect/Engineer Fees	<u>7.9%</u>
Additional Architect/Engineer Fees	\$ 5,495.00
Total Cost of Additional Fees added	
to Project	<u>\$10,045.00</u>

Obviously, procurement of basic equipment under the prime contract resulted in an increase of over \$10,000 for the goods.

The Director of Engineering & Operations indicated that this was an effort by the Department of Mental Retardation to coordinate with the Department of Mental Retardation dentist in charge, distributor and

contractor the most efficient and workable installation of this technical dental equipment. He additionally indicated that this was the only option open that would allow the contractor's one year warranty to include this work. Further, the Director indicated that it was verbally understood at the signing of the prime contract that the basic equipment would be included.

South Carolina Department of Mental Retardation's construction files neglected to document this decision-making process sufficient to satisfy external audit purposes.

We, therefore, recommend that the Department of Mental Retardation establish a written determination for the files that support increases to prime contracts that involve reclassification of E-11 line items from direct procurement to contractor procurements. This determination should explain the following:

- (1) The technical problems that are overcome by such a decision.
- (2) The cost advantage to the State.
- (3) The increase in effectiveness in meeting the needs of the agency.

This determination would be a simple, internal, support statement indicating how and why such decisions are made. As a result, an effective audit trail would be left to properly evaluate the Department of Mental Retardation's stewardship of taxpayer's dollars.

III. Planning and Scheduling Acquisitions

A. Developmental Disabilities Grant

Our examination included a review of one grant to the Department of Mental Retardation from the office of the Governor under the Developmental Disabilities Program. The contract is a purchase and provision of case coordination service for developmentally disabled persons, primarily in the Charleston area.

We noted two areas of concern under this grant:

- (1) The grant calls for consultant services in the development and delivery of these services without any attempt to evaluate if these persons are properly defined as consultants or employees.
- (2) The grant dictates that furniture and fixtures be rented or leased unless prior approval be received to purchase such equipment as needed.

Our review has determined that:

- (1) Those persons under the grant receiving consultant fees are thought by regional management to be in a employee-employer relationship.
- (2) The funds expended in annually leasing the furniture and fixtures far exceeds the cost of the asset if purchased outright.

There appears to be some confusion as to the responsible managerial party at the Department of Mental Retardation. There is a feeling at the agency that the Governor's Office dictates the means and procedures that

are required to deliver these services.

This, of course, is not the condition. The terms of the contract for the purchase of service dictates the terms under which the Department of Mental Retardation will deliver the service.

Section VII(A) of the contract states:

The Provider (Department of Mental Retardation) represents that he has, or will secure, all personnel required in performing the services under this contract. Such personnel shall not be employees or have any contractual relationship with the Administering Agency (Governor's Office).

All of the services required will be performed by the Provider or under his supervision....

As a result of the Department of Mental Retardation's unfamiliarity with the provisions of the contract, funds are being expended under consultant agreements that are potentially in violation of state and federal laws.

Section IV(A) of the contract states:

The Administering Agency (Governor's Office) will make payment only for allowable expenditures reasonably and necessarily incurred by the Provider in the course of providing developmental disabilities services pursuant to this contract.

Lack of Department of Mental Retardation managerial controls resulted in excessive funds being expended for the leasing of furniture and fixtures when a more cost effective option was available, i.e., the purchase of the equipment.

Attachment IV, page 3, to the contract acknowledges the possibility of the purchases of equipment with prior written HHS approval. Of further consequence, this indicates a reluctance by the Department of Mental Retardation to exercise its managerial authority as outlined in the Procurement Manual, Article 1 of the Procurement Code, and the purchase of service contract itself.

We, therefore, recommend that a review be conducted by the Director of Personnel to determine the status of all present consultant agreements, agency

wide, and take necessary corrective action as to their status. Assistance in this area can be obtained from the Director of Audit and Certification, Materials Management Office.

We further recommend the Director of Planning and Grants with the assistance of the Director of Supply and Support Services review all existing grants involving procurement of goods and services, whether by lease or purchase, and justify that the procedures employed by the Department of Mental Retardation are expending public funds economically and in the best interest of the State and its citizens.

B. Corrective Action Recommended by External Audit

Our examination revealed that the South Carolina Department of Mental Retardation recently entered into a new two year contractual agreement with a CPA firm to prepare its Medicaid and Medicare cost reports. (This service has been acquired for several years.) The CPA firm supplies the Department of Mental Retardation with a management letter as a result of its work, with recommendations for corrective action.

Additionally, the CPA firm is required to train a member of the Internal Audit staff as to the Medicaid/Medicare principles of reimbursement.

The cost of this service is \$72,000 for the year ended 1982 and \$79,000 for the year ended 1983. The contract has built-in escalation of fees if an increase in licensed beds occurs within these periods.

This agreement was approved by the State Auditor's Office in December, 1981.

The justification of need is predicated on the condition that the Department of Mental Retardation has no one on staff with the expertise to deal with the complexity of the Medicaid/Medicare reimbursement regulations and

prepare them in accordance with the principles of Reimbursement for Provider Costs as published by the Secretary of Health and Human Services and the State Plan for Medical Assistance.

Our examination of the CPA management letters in 1980 and 1981 revealed that many of the audit findings and recommendations were repeated. This indicates that the Department of Mental Retardation neglected to take necessary corrective action which would lessen the audit effort by the CPA firm in subsequent periods, and thereby should reduce the cost of the service.

Partially as a result of this we believe, the cost of this expertise has steadily risen over the past four years, all of which cannot be associated with inflationary pressures.

While we commend the Department of Mental Retardation's addition in this last contract of a contractual clause providing for training of a staff person in this field, we must recommend that a timely response be made to the CPA management letter indicating prompt corrective action or management's reasons for disagreement.

This action should improve the financial records, leave more visible audit trails and lessen the overall cost of providing this service, thereby ensuring the most efficient use of state and federal funds.

Additionally, as staff expertise increases, we recommend the Department of Mental Retardation perform a study to compare outside cost to the in-house cost of preparing these reports. This study should be in the contract files supporting the decision of the agency.

C. Lab Services Contracts

As a part of our testing we reviewed the contract with Physicians Clinical Lab, Inc. at Whitten Center. The vendor provides lab testing services for clients, autopsy service and other consulting services. Under this contract the vendor bills the Department of Mental Retardation, rather than the Medicare intermediary, for services rendered on behalf of clients.

Inquiry determined that in the other regions different contractual agreements are drawn and the vendor bills the Medicare intermediary direct for covered services and the Department of Mental Retardation for the remaining uncovered services.

Each region establishes its own contract and makes its own source selection as to vendor and billing procedures.

Due to lack of communication between regions of common services needed, Whitten Village is burdened with the outpatient billing procedures for reimbursement, while other regions are free of this additional cost and effort.

Additionally, the agency's buying power and contractual leverage is reduced by the lack of standardization of this contractual service.

This type of common need lends itself so well to agency term contracts, we question whether the funds of the State are effectively used by allowing regions to establish their own agreements.

We, therefore, recommend that the Director of Supply and Support Service initiate a review of contractual services contracts with a view toward maximizing the agency buying power and providing the most efficient method of reimbursement in lab services.

IV. Property Management - Surplus Property

Our examination of the Central Warehouse System determined that the Department of Mental Retardation's policy and procedures effectively and efficiently support the overall goals of the agency and are adequately controlled.

Additionally, the majority of items that become "dead stock" or surplus are promptly flagged and disposed of usually through inter-regional transfer.

However, our examination did reveal a large inventory of clothing and related items to be in a "dead stock" condition.

This is a result of a change in the agency policy regarding the source of clothing for the client population. To promote normalization, the South Carolina Department of Mental Retardation feels that, whenever possible, the client should procure, or participate in the procurement, of his or her own clothing. Also, if a client has personal funds available, regulations require that such items be paid from this source.

Due to this change, the issues of clothing from Central Warehouse have been significantly reduced and a resulting overstock condition exists.

Section 19-445.2150 of the Regulations states:

All governmental bodies must identify surplus items, declare them as such, and report them to the Materials Management Officer or his designee within 90 days from the date they become surplus.

We commend the Department of Mental Retardation for their prompt identification of this inventory as surplus. However, we recommend that notification be given to the Surplus Property Section, Division of General Services, to effect a timely and efficient disposal of this property, by either sale or transfer.

V. Fiscal Accountability Act

Partially, as a result of lack of clarification as to report procedures statewide, the Department of Mental Retardation has failed to comply with the requirements of the Fiscal Accountability Act in the following areas:

- (1) Failed to report to the Comptroller General (CG) a statement of all existing contracts for permanent or capital improvements and the status of the work pursuant to such contracts.
- (2) Neglected to report all expenditures as required under the Act.
- (3) Neglected, since the passage of the Act (1976), to reconcile the data collected for FAA reporting to General Services with the Accounts Payable check distribution files of the Department of Mental Retardation.

Act 561 of 1976, Section 4, states in part:

The quarterly reports required by this act shall include the following information current to the end of the last preceding quarter;

- (2) A statement of all existing contracts for permanent or capital improvements and the status of the work pursuant to such contracts....

Additionally, Section 5 states in part:

All agencies, departments and institutions of state government shall...furnish to the Division of General Services of the Budget and Control Board...a statement of all expenditures... for commodities which were not purchased through the Division. Such statements shall be prepared in the commodity code structure and report format established by the Division for reporting commodities purchased through the Division's central purchasing system....

...Expenditures for units under two hundred dollars shall be reported in the aggregate and units in excess of two hundred dollars shall be itemized.

Further, 561 as amended May 30, 1977, states in part:

...it is the intent of the General Assembly that all funds including state, federal, and other agency revenues, and also including any financial transactions covered by the budget code of the Comptroller General's office, be included in the reporting requirements of this Act....

Our test of two regions determined that all commodities have not been reported due to the following procedures:

Coastal Region

All items processed through Purchasing and Supply with purchase order numbers are reported, regardless of the source of funds. However, blocks of purchase order numbers are assigned to Finance and these procurements are not reported.

Piedmont Region

Excluded for the reporting process are:

Object Code 200 - Contractual Services

Object Code 900 - Purchases for Resale

and,

only expenditures of state appropriated funds are reported. Excluded sources of funds are:

3000 - Other Funds

6000 - Donated Funds or Canteen

Further examination discovered that no person internally reviews the FAA reports and that no management effort is made to financially reconcile the procurement data to the external reporting process since the enactment of FAA. Materially, after the original purchase order is prepared and entered into the data base for FAA, the task is considered completed. Any change orders or alterations to the original do not appear to be entered into the same data base. Therefore, the total dollar amounts of procurements as finalized are inaccurately reported.

The General Assembly, without a major audit effort, cannot readily know the procurement activity of the Department of Mental Retardation in the areas of:

- (1) Permanent and capital improvements;
- (2) Total commodities purchased with any degree of fiscal reliability.

Additionally, by not establishing FAA input as a reliable data base, the Department of Mental Retardation deprives itself of the internal fringe benefits that could result therefrom, such as:

- (1) Planning and scheduling acquisitions;
- (2) Consolidation of commodities for better prices;
- (3) Monitoring of user department needs for efficiency, cost effectiveness and small order abuse;
- (4) Evaluation of purchasing goals.

Until such time as updated statewide guidelines are finalized, we recommend the Department of Mental Retardation take prompt action to establish and implement the necessary controls to ensure the following:

- (1) The Comptroller General receives a quarterly report on all existing contracts and status of work done on capital and permanent improvements;
- (2) That the Deputy Commissioner of Administration review the "Direct Purchase Order Reporting System - User/Procedure Manual" published July, 1979 by the Department of Mental Retardation and update and clarify the requirements in light of this finding. Additionally, all procurement centers should be instructed to adhere to accurate and complete reporting procedures so that all purchases are reported to the Central Data Center.

VI. Personal Needs Funds

- A. Contributions by Department of Mental Retardation to Personal Needs Fund and Purchases on Behalf of Clients from Personal Needs Fund

Our examination revealed that the Department of Mental Retardation has the responsibility, per the contractual agreement for Medicaid, to administer the clients' personal needs funds. The Department of Mental Retardation exercises this function under a power of attorney granted by the client and/or the parent, guardian or governmental agency.

Medicaid clients receive Social Security Assistance (SSA) monies on a monthly basis which are applied as a reduction of their health care cost incurred by the Department of Mental Retardation. The remaining cost is paid by the Medicaid program via the South Carolina Department of Social Services. Twenty-five dollars of this SSA monthly assistance is required by federal and state regulations to be deposited in each client's personal needs account.

The Department of Mental Retardation's internal policy requires that twenty-five percent or \$25 per month, whichever is greater, be deposited in each client's personal needs account.

There is no provision in either federal or state law that allows the Department of Mental Retardation an expenditure in excess of \$25 per month on behalf of the client for personal needs.

As a result of Department of Mental Retardation policy, client's funds accumulate significant balances. Federal and state regulations state that any client accumulating assets in excess of \$1,500 is not eligible for Medicaid benefits. When a client loses his Medicaid eligibility, his personal needs fund must be used to pay for routine care and maintenance until they are reduced to the allowable balance.

For funding source reasons, the Department of Mental Retardation prefers its clients to maintain their Medicaid classification.

We understand that the Department of Mental Retardation is making a concerted effort to resolve the issue of contributions in excess of \$25 per month per client.

Our recommendation is that federal and state requirements be adhered to. We feel the following would result:

- (1) The vast majority of the client population's personal needs would be financially met.
- (2) The funds would be spent more economically and efficiently.
- (3) The savings that would result could be used in the Department of Mental Retardation's budget and be expended more effectively on that portion of the population needing it the most.

B. Co-Mingling of Purchases from Personal Needs Funds with State Funded Purchases

Our examination revealed that the South Carolina Department of Mental Retardation is purchasing personal commodities on behalf of its clients from state appropriated funds and, after delivery, seeking repayment from the client personal needs funds. If the client does not have sufficient funds to repay the Department of Mental Retardation, the purchase becomes an expense to the State.

The Appropriations Act requires that state funds be used to meet the ordinary expenses of the agencies.

Additionally, prudent management principles indicate that transactions involving client funds not be co-mingled with that of the State.

Inquiry determined that the Department of Mental Retardation feels the client's relevant needs and/or wants are of paramount importance for his personal growth, of course under the agency's professional guidance. Therefore,

the need will be met regardless of source of funds. Safeguarding the assets of the State and, in fact, the client have secondary importance.

This approach results in poor administrative control over transactions of this nature.

We, therefore, recommend that the Department of Mental Retardation establish and implement a procurement procedure apart from the agency's for client purchases. This would require that fund availability be determined prior to purchase and would ensure that state funds are spent as a source of last resort to meet client's personal needs.

These procedures should incorporate:

- (1) A purchase order different from the agency's.
- (2) A classification that would exclude these expenditures from the agency's routine encumbrance and expense reports.
- (3) Compliance to Department of Mental Retardation Administrative Directive #8104, "Financial Management of Resident's Personal Funds".

These procedures should be standardized agency-wide.

VII. Internal Audit

As a result of the findings in this report, greater involvement by the Department of Mental Retardation's Internal Audit Department is considered desirable.

A complete internal audit program includes a periodic review of the system of requisitioning, placing of purchase orders, receiving, etc. to determine that procurement procedures are sound and are being adhered to

by user departments. As a state-supported agency the program must also include a review of the procurement process for compliance with the Consolidated Procurement Code and regulations, as well as other applicable laws and regulations.

Historically, due to time limitations, agency internal audit departments have been forced to concentrate their efforts in the financial area, which precluded compliance and operational programs.

This leaves a gap in the administrative control over the procurement function because this area goes without review except by external audit organizations. Although these are effective, they cannot provide the type of on-going control necessary in an area where such large sums of money are expended.

The Institute of Internal Auditors' publication entitled Standards for the Professional Practice of Internal Auditing states, "The scope of Internal Audit should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities." We feel this expands the role of Internal Auditors into the areas of compliance, management and operational reviews of all areas and functions of an organization.

We suggest that Internal Audit programs be developed to test the procurement process for adequacy of internal control, compliance with the Consolidated Procurement Code, adherence to Department of Mental Retardation's procedures and overall effectiveness. This program should include but not be limited to periodic review of procurements at all dollar levels including the assignment by Finance of direct purchase order numbers and central warehouse operations.

We recognize that plans have been underway in the Internal Audit Section to incorporate tests of the overall procurement function into their audit

schedules. We feel this program will be advantageous to the Department of Mental Retardation by providing needed control over the procurement function.

VIII. Review of Department of Mental Retardation's Procurement Manual

Our examination of the Department of Mental Retardation Policy and Procedures Manual has indicated the following areas need to be addressed and/or expanded in the current document submitted to the Materials Management Office for approval prior to certification:

(1) Ethical Standards

Guidelines enumerating the ethical standards required by law to be followed by all governmental bodies in carrying out their procurement activities should be referenced in the appendices.

(2) Organization

An organizational chart of the Procurement Division which defines positions and duties of the staff and which designates authorized approval signatures.

(3) Procedures Flow Chart

A procedures flow chart showing the document processing flow for the four types of procurement (where applicable): 1) goods and services; 2) construction and related professional services; 3) consultant services; 4) information technology in the regions other than the central warehouse operations.

(4) Purchase Requisition Process

The specific procedures to be followed by the governmental body when procurements are made in any of the

four areas of procurement as enumerated above. For example, describe the purchase requisition process, use of direct purchase vouchers where applicable, selection and contracting procedures for professional and consultant services, etc.

(5) Receiving, Warehousing and Quality Assurance

Procedures to be followed with respect to receiving goods, shipping goods from the governmental body, damage claims, duplicate shipments, maintenance stores, warehousing, quality assurance.

(6) Grievance and Complaint Procedures

Designate the procedures to be followed by the governmental body in receiving and attempting the settlement of a vendor or contractor complaint and in initiating a complaint against a vendor or contractor.

(7) Determination Reports as Listed in Section 11-35-2410, Consolidated Procurement Code

(8) Bid Security and Bid Opening Procedures

(9) Quarterly Report Forms of Purchases to Comptroller General, Legislative Audit Council

(10) Change or Amendment to Purchase Order and Contract Procedures

(11) Authorized Signature Forms for Division Heads and Location Where Kept

(12) Blanket Purchase Order Logs, Agreements, Alternate Sources

(13) Professional Development

(14) Update Exhibits to Current Forms Applicable
as Directed by Department of Mental Retarda-
tion and Materials Management Office Policies

The agency internal Policy and Procedures Manual is a vital asset to the Procurement Division and internal control of its functions. In addition, expansion of the manual is necessary to ensure standardization throughout the Department of Mental Retardation.

SUMMARY OF AUDIT CONCLUSIONS

We have examined the procurement policies and procedures of the South Carolina Department of Mental Retardation for the period July 31, 1981 - April 28, 1982. As a part of our examination, we reviewed and tested the Department of Mental Retardation's system of internal control over procurement transactions to the extent we considered necessary to evaluate the procurement system. The purpose of such evaluation was to establish a basis for reliance upon the system of internal control to assure adherence to the Consolidated Procurement Code and State and Department of Mental Retardation's procurement policy. Additionally, the evaluation was used in determining the nature, timing, and extent of other auditing procedures that were necessary for developing a recommendation for certification above the \$2,500 limit.

The objective of internal control is to provide reasonable but not absolute, assurance of the safeguarding of the procurement process, and of the reliability of the purchasing records. The concept of reasonable assurance recognizes that the cost of a system of internal control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depend upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect to the execution and recording of transactions. Further, projection of any evaluation

of internal control to future periods is subject to the risks that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate.

It should be understood that our study and evaluation of the agency's system of internal control over procurement operations for the period July 31, 1981 - April 28, 1982, which was made for the purpose set forth in the first paragraph above, would not necessarily disclose all weaknesses in the system.

Our review of the system of internal procurement control did, however, disclose the aforementioned conditions which we believe require improvement.

Corrective action based on the recommendations described in these findings, we believe, will in all material respects place the Department of Mental Retardation in compliance with the South Carolina Consolidated Procurement Code and ensuing regulations.

Under the authority described in Section 11-35-1210 of the Procurement Code, subject to the above corrective action, we recommend the South Carolina Department of Mental Retardation be certified to make direct agency procurements as follows:

<u>PROCUREMENT AREA</u>	<u>RECOMMENDED CERTIFICATION LIMIT</u>
Term Contract for Pharmaceutical Drugs	Total Amount Not to Exceed \$600,000 Per Year

The Department of Mental Retardation's request for consultant services certification was primarily for the procurement of medical doctors and temporary nursing services. The Budget and Control Board at its July 13, 1982 meeting exempted these services from the purchasing procedures and reporting requirements in the Consolidated Procurement Code. This action makes certification unnecessary in this area.

The Department of Mental Retardation's request for architectural/ engineering services certification is provided for in Section 19-445.2145, subsection F of the Regulations, thereby making certification unnecessary in this area.

We are unable to recommend certification in response to the Department of Mental Retardation's request for repair services, renovation and construction limits. Procedures for control of these areas have not been finalized statewide by the Budget and Control Board and the Joint Bond Review Committee.

Our examination included a review of these areas, so once the aforementioned items are completed and take effect we will be able to make recommendations for certification after a limited follow-up review.


Walter A. Taylor
In Charge Auditor


Robert W. Wilkes, Jr., CPA
Director, Audit and Certification

CHARLES D. BARNETT, Ph.D.
Commissioner

WALTER B. TODD
Deputy Commissioner,
Administration

WADE C. WIETERS, Ed.D.
Deputy Commissioner,
Professional Services



MENTAL RETARDATION COMMISSION

The Rev. J. E. Hunter, D.Min., Chairman
Herbert Rudnick, Vice-Chairman
Mrs. Elizabeth P. Stall, Secretary
Robert H. Lovvorn, Sr.
Mrs. Mary C. Ramsay
R. B. Robinson
The Rev. George W. Watson

STATE OF SOUTH CAROLINA
DEPARTMENT OF MENTAL RETARDATION
2712 MIDDLEBURG DRIVE
P. O. BOX 4706
COLUMBIA, SOUTH CAROLINA 29240

NOV 19 1982

November 12, 1982

Ms. Barbara A. McMillan
Director, Contracts & Audit Management
Materials Management Office
Division of General Services
800 Dutch Square Boulevard, Suite 150
Columbia, South Carolina 29210

Dear Ms. McMillan:

Enclosed is our reply to the audit and certification report of
October 25, 1982.

Sincerely,

Walter B. Todd
Deputy Commissioner,
Administration

WBT/hs

Enclosure: a/s

cc: Dr. Charles D. Barnett

November 12, 1982

SUBJECT: SCDMR Response to Findings and Recommendations of Procurement Audit (Draft)
for the Period July 31, 1981 - April 28, 1982.

The following comments are numbered to correspond with paragraph numbers of the procurement audit (draft) document dated October 25, 1982.

Section I

- A. A review procedure to measure regional procurement efficacy and compliance with the Code and SCDMR Procurement Manual will be developed and implemented to the extent practicable with available personnel resources. Target date for development is January 31, 1983.
- B. Standard initial request documents and authorization procedures will be developed and incorporated in the SCDMR Procurement Manual. Target date for implementation is January 1, 1983.
- C. Regional receiving procedures will be reviewed, standardized, and incorporated in the SCDMR Procurement Manual and the FAS Manual. Target date for implementation is January 1, 1983.
- D. A single purchase order register, elimination of "dummy" purchase order numbers, and control of all purchase orders by the regional purchasing manager are goals to be achieved. Checks for adherence to the Code and sound management practices shall be included in the review procedure to be developed as described in paragraph A above.
- E. Currently, there is no provision for a direct voucher system within STARS accounting according to knowledgeable staff personnel in the offices of the Comptroller General and the State Treasurer. In view of the Department's scheduled loss of its lump sum status in FY 83-84 and costs to change the current SCDMR accounts payable system, no changes should be undertaken at this time.
- F. A formal change order form has been devised and is being tested at one regional center and at the central warehouse operation. Target date for completion of testing and implementation by all SCDMR regional centers is December 15, 1982.
- G. On vouchers in question, if check numbers are provided us, explanations can be given that may affect the percentages stated in the audit test.
- H. The recommendation that a copy of the requisition should be attached to the voucher package would require additional copies in order to maintain a closed purchase order file. All invoices carry the sign off or initial of the person responsible for checking that proper receiving procedures were complied with. The present approval form precludes the need for extensive documentation in the central voucher payment file that is more logically located in Regional Center files. Appending purchase orders, change orders, receiving documents, and issue documents to payment vouchers would represent an unnecessary and expensive duplication of original files and create new work requirements at regional centers and in the central finance office.

- I. The recommendation to perform a cost study of Centralized versus Decentralized Procurement is noted.

Section II.

A, B, C and D. Compliance with the Code and the SCDMR Procurement Manual will be part of continuous review procedures by Central Office Staff and the Office of Internal Audit.

E. Supporting documentation for the change from direct procurement to contractor procurements is in the files. Plans and specifications are as important a part of the project files as the communication files. Plans clearly indicate a stubout for oxygen, vacuum, and nitrous oxide near the chair for hook up to portable dental equipment. As-built drawings indicate the equipment to be built-in. This was at the request of the new dentist and did not provide an alternative for direct procurement.

In the future, additional documentation for justification of a change from direct procurement to contractor procurement will also be included in the correspondence files to further assist the auditors.

Section III.

A. The findings of the audit staff of the Audit Section of the Materials Management Office are incorrect with regard to the administration of the Department of Mental Retardation's (DMR) Developmental Disability Grant.

- (1) Those individuals employed under the Developmental Disability Grant were included in SCDMR's payroll effective November 1, 1982. They were placed in the Special Contract Employee Classification which recognizes the employee-employer relationship that exists between these employees and the Coastal Region. It should be noted that the Special Contract Employee Classification was not available for our use when these individuals were initially employed. The Director of Personnel will review all contracts to determine if individuals are consultants or if they should be considered employees. Target date for completion of review is January 1, 1983.
- (2) There is no confusion as to the responsible managerial party at the DMR concerning administration of this grant. Contract Attachment III; Section I clearly states:

Program personnel will be administratively supervised by the agency or organization (DMR) sponsoring the Case Coordination Program; however, program personnel will be directly responsible to and accountable to the Administering Agency, the Developmental Disabilities Program Administration, both programmatically and fiscally, in order to ensure compliance with federally mandated requirements.....
- (3) With regard to the leasing of furniture and fixtures, even though the cost exceeds the cost of such assets if purchased outright, the Operations Manual for the Office of Executive Policy and Procedure (OEPP), Section 1011 (Note); page 30 states:

It is the policy of the DD council
that DD funds are not to be used
for the purchase of equipment.

As the rules and policies of the OEPP and the Administering Agency would be subrogate to the Procurement Manual, there is clearly no indication of reluctance by DMR to exercise managerial authority under Article I of the Procurement Code which has no bearing on the grant in question.

- B. Responsive action is always underway to recommendations being made to DMR by its External Audits. We are constantly improving our records and recordkeeping to comply with the CPA Management Letter and changing Federal Audit requirements. Some of the requests are very complex and require major changes to existing systems. These may appear on the surface to have had little attention due to their complex nature. Prompt corrective action is given to changes which improve reporting and which are cost effective. The cost over the past years has been on the decline (initially \$500,000). This is a large program and it is very important to have unbiased, well accepted reports. We call to your attention that the \$72,000 paid for services for FY 82 will yield over 30 million dollars to DMR in FY 83. The current contractual arrangement is obviously more economical than the use of State employees. In order for the state to produce these reports it is estimated that three CPA's, one junior accountant, one clerical person and computer software would be required.
- C. The Director, Supply and Services and the Director of Personnel will review regional contracts for possible consolidation of requirements and establishment of single contracts for common services. Target date for completion of study and recommendations is January 1, 1983.

Section IV.

Surplus clothing in the department central warehouse is being identified and will be reported to the Materials Management Office. Target date for requesting disposition action on all items of clothing known to be surplus is December 1, 1982.

Section V.

- (1) There has been no request from the Comptroller General's Office for information beyond that which is being supplied to them. The reports on contracts were deleted from the reporting requirements by LAC through an amendment to Act 561 which went into effect 7/01/78.

The General Assembly can readily know the procurement activity of DMR in the areas of permanent and capital improvements. All reporting is maintained both in the Engineering and Planning Division as well as the State Engineer's Office and identifies type of procurement effected.

- (2) The Director, Supply and Services has reviewed the SCDMR Direct Purchase Order Reporting System Manual (1979) for adequacy of guidance, and a change relating to fund sources is scheduled for publication November 22, 1982.

Section VI.

- A. The department will review the current administrative directive (ADMIN 81-04), Financial Management of Resident's Personal Funds, from the viewpoint of compliance with the three principles listed in the audit recommendation.
- B. It is the goal of this agency to meet the needs of each client in the most economical and programatic way.

The Department continuously monitors to assure that State funds are not misused and to determine the most efficient and primary use of funding sources. Normalization to the maximum extent possible for each individual client is the ultimate goal. If a requirement exists for the use of State Funds to purchase an item that appears to be personal in nature--then all procurement regulations of the State will be followed.

It is the practice of this Agency to buy directly only for a client who has no personal funds. It does not seem wrongful for the State to be reimbursed for a purchase which may have been made from State funds, as long as the funds are re-deposited to the same account.

Section VII.

Noted. The Internal Auditor is aware of the need to develop audit programs to examine the effectiveness of the department's procurement and supply system and for compliance with the SCDMR Procurement Manual, State Regulations and the Consolidated Procurement Code.

Section VIII (Page 50)

- (1) Standard ethical guidelines for SCDMR employees engaged in procurement functions will be added to the SCDMR Procurement Manual by December 1, 1982.
- (2) and (3) An organizational chart of procurement positions and a document processing flow chart will be included in a change to the SCDMR Procurement Manual by December 1, 1982.
- (4) Purchasing requisition procedures delineated in the SCDMR Procurement Manual are considered to be adequate, but a review will be conducted to determine if further expansion is necessary. A change to the SCDMR Procurement Manual reflecting recent changes in State regulations on procurement of professional and consultant services has been prepared and will be published by December 1, 1982.
- (5) Guidance on supply procedures will be included in a separate publication or as a change to the SCDMR Procurement Manual. Target date for completion is February 1, 1983.
- (6) A change to the SCDMR Procurement Manual will include guidance on vendor complaints and agency complaints against vendors. Target date for completion is December 1, 1982.

- (7) New determination reports and officials authorized to sign determinations were included in Change 1 (6/23/82) of the SCDMR Procurement Manual.
- (8) Bid security and bid opening procedures will be included in the SCDMR Procurement Manual. Currently, they are applicable only to the annual drug buy and procurement of public official/honesty blanket bond/constables bond/broad form money and securities policy. Inclusion of details on bid security, bid opening procedures, and changes to contract procedures are not applicable to the construction and related professional services phase as this is dictated and monitored by the Budget and Control Board as well as the Joint Bond Review Committee.
- (9) through (13). Noted or previously addressed.
- (14) Exhibits of current forms were updated by Change 1 to the SCDMR Procurement Manual and continuous review will be performed to assure currency.

MAY 04 1983

CHARLES D. BARNETT, Ph.D.
Commissioner

WALTER B. TODD
Deputy Commissioner,
Administration

WADE C. WIETERS, Ed.D.
Deputy Commissioner,
Professional Services



MENTAL RETARDATION COMMISSION
The Rev. J. E. Hunter, D.Min., Chairman
Herbert Rudnick, Vice Chairman
Mrs. Mary C. Ramsay, Secretary
Robert H. Lovvorn, Sr.
William deB. Mebane
R. B. Robinson
The Rev. George W. Watson

STATE OF SOUTH CAROLINA
DEPARTMENT OF MENTAL RETARDATION
2712 MIDDLEBURG DRIVE
P. O. BOX 4706
COLUMBIA, SOUTH CAROLINA 29240

May 3, 1983

Ms. Barbara A. McMillan
Director, Contracts and Audit Management
Materials Management Office
Division of General Services
800 Dutch Square Blvd., Suite 150
Columbia, South Carolina 29210

Dear Ms. McMillan:

In reply to a request made by Mr. Walt Taylor of your office on May 2, 1983, we submit the following correction to Section III of our November 12, 1982 correspondence.

Section III (3) is being revised to include the attached waiver to contract #212-21-0009/0005. This waiver will allow the Department to purchase the equipment in question. This purchase will be completed by May 31, 1983.

If you have any questions, please contact me.

Very truly yours,

H. C. Steele, Jr.
Director of Finance

HCSjr/dsc

Attachment

cc: Mr. Walter B. Todd
Mr. Herbert Johnson
Mr. Timothy Boling

State of South Carolina

Office of the Governor

RICHARD W. RILEY
GOVERNOR

OFFICE OF EXECUTIVE
POLICY AND PROGRAMS

March 31, 1983

Ms. Joanna Jenkins, Administrator
Community Program
Vince Moseley Diagnostic Clinic
41 Bull Street
Charleston, South Carolina 29403

Dear Ms. Jenkins:

Through recent conversations with Mr. Heyward Caddell, I have learned that the equipment now being leased by the Case Coordination Program can be purchased for a minimal cost. The equipment presently being leased includes a typewriter and the office furniture. Mr. Caddell has informed me that for \$587.65 all of the equipment can be purchased before May 31, 1983.

I have requested Mr. Tim Boling to make the necessary line item changes in the budget. When these changes have been completed, I will send you a copy of the amended budget.

This letter serves as an official waiver for equipment purchase and, as such, becomes an official part of contract #212-21-0009/0005 and should be retained in your contract file.

If you have any questions, please contact me.

Sincerely,



Cissy Parades, Director
Developmental Disabilities Program
Administration

CP/cm

cc: Tim Boling
Jim Taylor
Heyward Caddell
Barbara Jardno
Jack Howell

Health and Human Services, Edgar A. Brown Building
1205 Pendleton Street, Columbia 29201

STATE OF SOUTH CAROLINA
BUDGET AND CONTROL BOARD
DIVISION OF GENERAL SERVICES

300 GERVAIN STREET
COLUMBIA, SOUTH CAROLINA 29201
(803) 754-3150



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CHAIRMAN,
HOUSE WAYS AND MEANS COMMITTEE

WILLIAM T. PUTNAM
EXECUTIVE DIRECTOR

TONY ELLIS

May 17, 1983

Mr. Richard J. Campbell
Acting Materials Management Officer
800 Dutch Square Boulevard, Suite 150
Columbia, South Carolina 29210

Dear Richard:

We have reviewed the progress of the Department of Mental Retardation toward implementing the recommendations in our audit report covering the period of July 31, 1981 - April 28, 1982. During the review, we followed up on each recommendation made in the audit report through inquiry, observation and testing.

Two items contained in the official response by the Department to our audit and certification report require further clarification from our standpoint.

- a) We do not agree with their response to Section III, A (page 2 of their response) that our findings in the matter are incorrect. Further in regard to the detail response contained in (3) under III, A concerning equipment purchasing versus leasing, we have received a memorandum directly from the Office of the Governor, Office of Executive Policy and Programs, which administers the federal program in question. This memo indicates that the Department of Mental Retardation was, in fact, not given a waiver (until March 31, 1983, upon our inquiry) to purchase equipment under the grant.

We acknowledge this fact. The point of our recommendation, however, that management had the right to request a waiver to purchase the equipment if it was the most economical alternative but did not exercise this option on a timely basis is still valid.

Mr. Richard J. Campbell
May 17, 1983
Page 2

- b) The Department's response to Section V (1) (page 3 of the response) states that there was an amendment to the Fiscal Accountability Act which deleted contract reporting requirements. In extensive research, we have been unable to locate such an amendment nor has the Department produced any proof of same.

We consider the above items to be problems of a technical nature dealing primarily with the written response by the Department and do not consider that they materially affect internal procurement control. Overall, the Audit and Certification Section observed during our review that the Department of Mental Retardation has made substantial progress toward correcting the problem areas found and improving the internal controls over the procurement system. We feel that, with the changes made, the system's internal controls should be adequate to ensure that procurements are handled in compliance with the Consolidated Procurement Code and ensuing regulations.

Since the initial request for certification, the Department has withdrawn its request to handle its own pharmaceutical term contract award and has opted to combine its needs with other state agencies to increase buying power. As indicated in the "Summary of Audit Conclusions" section of our report, we are unable to recommend certification in the repair, renovation, construction area at this time because statewide guidelines have not been formalized. Other requested areas of certification have been addressed by exemptions or other regulation.

There are, therefore, no remaining procurement areas for which certification has been requested. Because of this and because an adequate system of internal control over procurement exists, our recommendation is that the Department of Mental Retardation be allowed to continue procuring all goods and services, construction, information technology and consulting services up to the basic level of \$2,500.00 as outlined in the Procurement Code.

Sincerely,

Barbara A. McMillan, Director
Contracts and Audit Management

BAM:rms

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