

Internal Audit Report



Direct Pay Activity

Justina Heath
2024



SOUTH CAROLINA OFFICE OF THE STATE AUDITOR

1. Executive Summary

Objective

Management's objective with the direct pay activity are to ensure that payments are made for valid business purposes in a timely manner and that payments are allowed in accordance with State laws. Our objective is to provide assurance that internal controls are adequately designed and operating effectively to manage risks that may hinder the achievement of Management's objectives.

Background

According to the South Carolina Statewide Purchase Order Policy, Direct Pay is a financial payment transaction and is used to pay a vendor for the purchase of certain goods and services in limited circumstances. The Direct Pay process should be used only when the purchase order method is not practicable because the use of Direct Pay limits reporting data necessary for spend analysis by the State and agency. It should not be used as a matter of convenience as it leads to the reduction in controls and approvals. Direct Pay transactions may include items where individual payments (monthly or other frequency in a FY) are less than \$2,500. The improper use of the Direct Pay method may lead to limitations on an agency's ability to use this form of payment method. While most state agencies must adhere to the categories laid out in the SC Statewide Purchase Order Policy, SCDOT has an exempt status which allows the Agency to engage in direct pay transactions outside of the policy.

According to the South Carolina Procurement Code (Section 11-35-710(A)(1)), "The board, upon the recommendation of the chief procurement officer, may exempt governmental bodies from purchasing certain items through the respective chief procurement officer's area of responsibility. The board may exempt specific supplies, services, information technology, or construction from the purchasing procedures required in this chapter and for just cause by unanimous written decision limit or may withdraw exemptions provided for in this section. The following exemptions are granted from this chapter: (1) the construction, maintenance, and repair of bridges, highways, and roads; vehicle and road equipment maintenance and repair; and other emergency-type parts or equipment utilized by the Department of Transportation or the Department of Public Safety." As such, SCDOT frequently uses the direct pay method to pay for goods and services that fall into the categories listed above.

In order to ensure that direct pay transactions were in compliance with State and Agency regulations, IAS determined it was necessary to perform transactional testing over a sample of the Agency's entire direct pay population for fiscal year 2023.

Conclusion

In our opinion, controls are partially adequate in design and operating effectiveness for reducing some risks within the Agency's risk appetite. Risk exposure is determined to be Medium.

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2. Forward

Authorization

The South Carolina Office of the State Auditor established the Internal Audit Services division (IAS) pursuant to SC Code Section 57-1-360 as revised by Act 275 of the 2016 legislative session. IAS is an independent, objective assurance and consulting function designed to add value and improve the operations of the South Carolina Department of Transportation (SCDOT). IAS helps SCDOT to achieve its objectives by bringing a systematic, disciplined approach to evaluating the effectiveness of risk management, internal control, and governance processes and by advising on best practices.

Statement of Independence

To ensure independence, IAS reports administratively and functionally to the State Auditor while working collaboratively with SCDOT leadership in developing an audit plan that appropriately aligns with SCDOT's mission and business objectives and reflects business risks and other priorities.

Report Distribution

This report is intended for the information and use of the SCDOT Commission, SCDOT leadership, the Chairman of the Senate Transportation Committee, the Chairman of the Senate Finance Committee, the Chairman of the House of Representatives Education and Public Works Committee, and the Chairman of the House of Representatives Ways and Means Committee. However, this report is a matter of public record and its distribution is not limited.

Acknowledgment

We wish to thank members of management and staff in the Procurement Division for their cooperation in assessing risks and developing actions to improve internal controls and enhance operating performance.

Lead Auditor

Justina Heath
Manager

Reviewer

Mark LaBruyere
Director of Internal Audit Services



3. Internal Auditor's Report

November 15, 2024

Mr. Justin P. Powell, Secretary of Transportation
and
Members of the Commission
South Carolina Department of Transportation
Columbia, South Carolina

We have completed risk and control assessment of the South Carolina Department of Transportation's (SCDOT's) Direct Pay Activity. The objective of this assessment was to contribute to the improvement of risk management by evaluating SCDOT's exposure to risks and the controls designed by Management to manage those risks. Our engagement included two aspects:

- Facilitation of Management's assessment of risks associated with the direct pay activity
- Independent assessment of the design and effectiveness of internal controls to determine whether those controls effectively manage the identified risks to an acceptable level.

We planned and performed the engagement with due professional care in order to obtain sufficient, appropriate evidence to provide a reasonable basis for our observations and recommendations. Our observations, recommendations, and management's action plans were discussed with management.

George L. Kennedy, III, CPA
State Auditor

4. Engagement Overview

Background

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In order to ensure that direct pay transactions were in compliance with State and Agency regulations, IAS determined it was necessary to perform transactional testing over a sample of the Agency's entire direct pay population for fiscal year 2023.

Objective

Management's objective with the direct pay activity is to ensure that payments are made for valid business purposes in a timely manner and that payments are allowed in accordance with State laws.

Our objective is to provide assurance that internal controls are adequately designed and operating effectively to manage risks that may hinder the achievement of Management's objectives.

Scope

While the direct pay method is used by several divisions throughout the Agency, IAS used a risk-based approach to select certain budget line items to test. IAS tested a total of 125 transactions.

Our scope included the accounts above and transactions for the period July 1, 2022 through June 30, 2023.

Methodology

For the direct pay activity included in the engagement scope, we performed the following procedures:

1. We facilitated Management's completion of a process narrative that documented the steps in the process and the individuals responsible for those steps.
2. We observed the discussion by key process owners and other subject matter experts performing the steps in procedure 1.
3. We evaluated Management's assessment to determine it is reasonable and comprehensive.
4. We tested key controls intended to manage risks to determine if the controls are designed adequately and operating effectively. Testing may include inquiry, observation, inspection of documentation, and re-performance of process steps.
5. We developed, as needed, observations based on the assessments of controls which are not adequately designed and/or operating effectively.
6. We collaborated with Management to develop action plans to improve control design and/or operating effectiveness.
7. While our engagement will primarily focus on risk management, we may identify other matters that represent opportunities for process improvement.
8. We collaborated with Management to identify opportunities and develop action plans for improving performance.

5. Conclusion

Direct Pay Activity Controls

The Agency has several internal controls to ensure that Direct Pay Activity is in compliance with State policies and procedures. In our opinion, controls are partially adequate in design and operating effectiveness for the Agency to achieve its goals. Risk exposure is determined to be Medium. Our observations and recommendations in combination with Management's action plans are expected to improve those internal controls and reduce risk exposures to within the Agency's risk appetite.

Development of Management Action Plans

We facilitated Management's development of action plans for each observation to improve control design with practical, cost-effective solutions. These improvements, if effectively implemented, are expected to reduce the overall risk exposure to an acceptable level (i.e. within the Agency's risk appetite).

We will follow up with Management on the implementation of the proposed actions on an ongoing basis and provide SCDOT leadership with periodic reports on the status of management action plans and whether those actions are effectively and timely implemented to reduce risk exposure to an acceptable level.

Observations

Observation 5.1 Inadequate Supporting Documentation	Risk Exposure Medium
Division: Procurement	
Control Assessed: Control 1 – Expense is supported by sufficient supporting documentation Control 2 – Expense is coded to the accurate general ledger account Control 3 – Expense was reviewed and approved by authorized personnel	
Control Description: Control 1 – Each transaction is required to have sufficient supporting documentation for all pertinent parties to review upon approving and processing the payment. Control 2 – Based on the supporting documentation provided, users will assign the appropriate general ledger account for the accounting department to code during their processing. Control 3 – To ensure that the expense represents a valid business purpose, each transaction is required to be reviewed and approved by authorized personnel prior to the Accounting Department processing the payment.	
Process Affected: Direct Pay	
Observation: Based on the testing performed, IAS determined that, while each direct pay transaction tested represented a valid business expense, adequate supporting documentation was not submitted to Accounts Payable (A/P) for several transactions. The likelihood of an erroneous, inaccurate, or fraudulent transaction is greater without adequate supporting documentation. Additionally, without adequate supporting documentation, A/P staff and management do not have the opportunity to exercise professional skepticism when processing payments. Recommendation 1: We recommend that SCDOT implement a requirement for business entities to submit adequate documentation (without personally identifiable information) to A/P to support that each transaction is accurate and represents a valid business purpose.	
Management Action Plan (MAP) 5.1	
It is the responsibility of each SCDOT department to attest that payments are made in accordance with the mission of the Agency and to provide necessary documentation in support of payments. During payment processing, SCDOT Accounts Payable scans all	

payment requests along with supporting documentation into SCEIS. These documents are subsequently reviewed by the Comptroller General's Office who ensures there is satisfactory evidence of the propriety of the payment prior to approving which directs the State Treasurer to disburse funds. The specific type of SCDOT payments that IAS brought to our attention during this review were approved by the Comptroller General's Office and funds were disbursed. SCDOT appreciates the recommendations of IAS and their discussions with the SCDOT department who is responsible for the above referenced payment types about providing additional supporting documentation with future requests. Accounts Payable staff will be encouraged to continue to communicate questions and/or concerns to AP/Finance Leadership as they are reviewing and processing payment requests. The Finance Department will develop and communicate guidelines to SCDOT Offices regarding payment requests which will include those made by Direct Pay.

MAP Owner:	Chief Financial Officer
Division:	Finance
Scheduled Date:	January 31, 2025

Appendix A

RISK SCORING MATRIX

Risk significance is rated on a scale of 1 (lowest) to 25 (highest) and is the product of the risk consequence score (1 to 5) multiplied by the risk likelihood score (1 to 5). The following matrix provides a color scale corresponding to risk significance scores.

Likelihood	Frequent or Almost Certain	3-4 Low	9-13 Medium	14-17 Med-High	18-21 High	22-25 Extreme
	Likely	3-4 Low	5-8 Med-Low	9-13 Medium	14-17 Med-High	18-21 High
	Possible	3-4 Low	5-8 Med-Low	5-8 Med-Low	9-13 Medium	14-17 Med-High
	Unlikely	1-2 Minimal	3-4 Low	5-8 Med-Low	5-8 Med-Low	9-13 Medium
	Rare	1-2 Minimal	1-2 Minimal	3-4 Low	3-4 Low	3-4 Low
		Incidental	Minor	Moderate	Major	Extreme
		Consequence				

Appendix B

RISK APPETITE

Risk appetite is defined as the amount of risk the Agency is willing to accept in the pursuit of its objectives. Management's goal is to manage risks to within the appetite where mitigation is cost- beneficial and practical. Management has set the Agency's risk appetite by risk type using scoring methodology consistent with the Risk Scoring Matrix shown in Appendix A. Risk appetites by risk type are as follows:

RISK TYPE	EXAMPLES	RISK APPETITE SCORE 1 = Minimal Risk 25 = Extreme Risk (See Scoring Matrix in Appendix B)
Safety	Employee and Public Well-Being	2
Ethical	Fraud, Abuse, Mismanagement, Conflict of Interest	2
Financial	Funding, Liquidity, Credit, Reporting	4
Strategic	Resources not Aligned, Unclear Objectives	4
Reputational	Unintentional Unwanted Headlines	4
Operational	Delays, Cost Overruns, Waste, Inefficiency	6
Regulatory	Non-Compliance	6
Legal	Lawsuits	10