



STATE OF NORTH CAROLINA

INVESTIGATIVE REPORT

**NORTH CAROLINA DEPARTMENT OF ENVIRONMENT
AND NATURAL RESOURCES**

DIVISION OF MARINE FISHERIES

RALEIGH, NORTH CAROLINA

DECEMBER 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Perdue, Governor
Members of the North Carolina General Assembly
Dee Freeman, Secretary, North Carolina Department of Environment and Natural Resources

Ladies and Gentlemen:

Pursuant to North Carolina General Statute §147-64.6(c)(16), we have completed an investigation of allegations pertaining to the North Carolina Department of Environment and Natural Resources, Division of Marine Fisheries. The results of our investigation, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with G.S. §147-64.6 (c) (12).

Respectfully submitted,

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

December 18, 2012

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INTRODUCTION

The Office of the State Auditor received a complaint that a Department of Environment and Natural Resources, Division of Marine Fisheries employee was awarding contracts to a company owned by a relative.

To conduct our investigation of this complaint, we performed the following procedures:

- Review of North Carolina General Statutes and Administrative Code
- Review of Department of Environment and Natural Resources policies and procedures
- Forensic review of computer hard drives
- Examination of relevant documents and records
- Interviews with employees of the Department of Environment and Natural Resources, the Department of Administration's Division of Purchase & Contract, and individuals external to state government

This report presents the results of our investigation. The investigation was conducted pursuant to North Carolina General Statute § 147-64.6 (c) (16).

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ORGANIZATION OVERVIEW

The North Carolina Department of Environment and Natural Resources (DENR) includes 15 divisions. Its mission is to conserve and protect North Carolina's natural resources and provide services that support and benefit the health and economic well-being of North Carolina's citizens.

DENR's Division of Marine Fisheries (Marine Fisheries) is responsible for the stewardship of the state's marine resources, which consists of all coastal waters up to 3 miles offshore. The mission of Marine Fisheries is to ensure sustainable marine and estuarine fisheries and habitats throughout the coastal region of North Carolina.

Marine Fisheries consists of nine sections. One of those sections, Resource Enhancement, manages shellfish resource development, habitat enhancement, shellfish mapping, shellfish leasing and shellfish disease work, as well as an artificial reef program.¹ Among these programs is an oyster rehabilitation program designed to help restore the State's oyster populations.

Oyster habitat is created by building reefs on previously viable oyster producing sites. The reefs are constructed with a combination of natural oyster shells and/or a type of stone material. Sources of oyster shells include donations from restaurants and individuals collected through the Marine Fisheries recycling program. Donors receive a tax credit of \$1 per bushel.² Marine Fisheries also purchases oyster shells from oyster shucking houses and is authorized to pay up to \$1 per bushel.

¹ <http://portal.ncdenr.org/web/mf/dmf-sections>

² NCGS §105-130.48

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FINDINGS AND RECOMMENDATIONS

1. A BIOLOGY SUPERVISOR SELECTED A RELATIVE'S COMPANY TO PROVIDE TRANSPORTATION SERVICES IN VIOLATION OF MARINE FISHERIES POLICY.

The Department of Environment and Natural Resources (DENR), Division of Marine Fisheries (Marine Fisheries) used the services of two trucking companies owned or controlled by the father-in-law, mother-in-law, and/or spouse of the Marine Fisheries employee responsible for their selection to haul oyster shells. The ownership interests of the father-in-law, mother-in-law, and the employee's spouse represent a conflict of interest prohibited by Marine Fisheries policy. The conflict of interest may also represent a violation of North Carolina state law. Between 2006 and 2012, Marine Fisheries paid the father-in-law's company \$209,001 for transportation services provided by the two trucking companies.

The Biology Supervisor in the Marine Fisheries Resource Enhancement Section was responsible for the Oyster Rehabilitation Program. His responsibilities included the purchase of oyster shells and arranging for the transportation of those shells to designated locations along the North Carolina coast. The Biology Supervisor's father-in-law owned the primary trucking company used to transport all the oyster shells purchased over the past nine years. In addition, the Biology Supervisor's spouse and mother-in-law each owned a 50% interest in another company that transported oyster shells.³ The father-in-law's company subcontracted some of its oyster shell transportation services to the company owned by the Biology Supervisor's wife and mother-in-law.

According to Marine Fisheries Policy ADM-7, "Every employee and supervisor of the Division of Marine Fisheries (DMF) is responsible for assuring employees do not conduct regulatory business of DMF in a manner that could be interpreted as a conflict of interest due to financial interest or relationship by blood or marriage. Examples include, but are not limited to: contracting for goods or services from a business with which there is financial or personal interest..."

In addition, North Carolina General Statute §14-234 (a)(1) states, "No public officer or employee who is involved in making or administering a contract on behalf of a public agency may derive a direct benefit from the contract except as provided in this section, or as otherwise allowed by law." General Statute §14-234 (a1)(4) states, "A public officer or employee derives a direct benefit from a contract if the person or his or her spouse has more than a 10% ownership or other interest in an entity that is a party to the contract."

The Section Chief to whom the Biology Supervisor reported was aware that the father-in-law owned one of the trucking companies used for the oyster shell transportation. The Section Chief did not consider the potential conflict of interest as a problem. However, the Section Chief did not know the Biology Supervisor's wife and mother-in-law co-owned the second company.

³ Regardless of ownership, the Biology Supervisor's father-in-law operated and managed both trucking companies.

FINDINGS AND RECOMMENDATIONS (CONTINUED)

RECOMMENDATION

The Biology Supervisor should not be involved in the vendor selection process, processing of invoices, or the confirmation of receipt of oyster shells due to the conflict of interest identified in this finding. DENR management should consider taking appropriate disciplinary action against the Biology Supervisor.

2. MARINE FISHERIES FAILED TO FOLLOW STATE PURCHASING REQUIREMENTS FOR THE PROCUREMENT OF TRANSPORTATION SERVICES.

Marine Fisheries did not seek competition for transportation services as required by the North Carolina Department of Administration, Division of Purchase & Contract (P&C). As the result of a misinterpretation of a special purchasing delegation,⁴ DENR personnel incorrectly advised Marine Fisheries it was not necessary to solicit bids for transportation services.

In 1951, DENR received a special delegation that the purchase of oyster shells did not require competitive bidding. However, that delegation did not mention the transportation of the shells. On April 27, 1989, a memorandum from P&C amended the special delegation so that it included both the purchase *and transportation* of oyster shells. However, this delegation was limited to those dealers having the capability of transporting their oyster shells to the place designated by Marine Fisheries. In all other instances, the *transportation* of oyster shells purchased by Marine Fisheries should have been competitively bid.

The special delegation was misinterpreted by DENR to include contracts for transportation not bundled with shell purchases. The origin of this misinterpretation is unclear, but it persisted until the terms of the special delegation were reconsidered as a result of our investigation. Marine Fisheries purchased some shells from businesses that provide their own transportation. For other shell purchases, Marine Fisheries selected the trucking company identified in Finding 1 of this report for transportation services. For oyster shell vendors that did not provide their own transportation, the transportation portion of the transaction should have followed P&C contract procedures to solicit competition.

The current State Purchasing Officer confirmed that the special delegation amendment would only include transportation if the company selling the shells had arranged its own transportation. DENR's Director of Purchase and Services agreed with the State Purchasing Officer's assessment.

⁴ The use of special delegations is covered in 01 NCAC 05B.1603. Additionally, the North Carolina Agency Purchasing Manual defines a special delegation as the authority granted by the State Purchasing Officer for an agency to handle a specific or special purchase where it would serve no practical purpose for the purchase to be handled by P&C.

FINDINGS AND RECOMMENDATIONS (CONCLUDED)

RECOMMENDATION

DENR should comply with state purchasing requirements. Specifically, Marine Fisheries should solicit bids for oyster shell transportation unless the oyster shell vendor transports the shells directly to the designated site.

3. MARINE FISHERIES FAILED TO FOLLOW DENR'S ACCOUNTS PAYABLE POLICIES AND PROCEDURES.

The Biology Supervisor created invoices for numerous vendors including his father-in-law's trucking company, oyster shucking houses, and fishermen. The Biology Supervisor also signed the invoices to indicate receipt of the oyster shells without an employee present at the time of delivery to confirm receipt. These practices violated DENR's policies and procedures for "Auditing Invoices."

DENR's internal procedures for processing invoices require that the "...*original invoice* [emphasis added] is to be forwarded to the division's designated accounts payable specialist after approval for payment is obtained." DENR's Purchasing Officer said that the vendor should provide the original invoice. As a result, the invoices created by the Biology Supervisor did not constitute an original invoice.

The Biology Supervisor and the Section Chief said the creation of vendor invoices was a practice that pre-dated their employment with the Resource Enhancement section. The Section Chief said, "I don't know how it started," but "it was just something that I inherited."

Additionally, DENR's internal procedures for processing invoices require that an Accounts Payable specialist verify that the required signatures are on the invoice before payment, including the "signature of receiver and date of receipt on the invoice." The Biology Supervisor signed the invoice to indicate that Marine Fisheries actually received the delivery of oyster shells prior to payment. However, the Biology Supervisor admitted that there was often no employee present at the drop-off site to confirm receipt of shell deliveries.

RECOMMENDATION

DENR should ensure that Marine Fisheries is following accounts payable policies and procedures. The Biology Supervisor should immediately cease creating invoices for vendors. Marine Fisheries should ensure that a mechanism is in place to properly account for all oyster shell deliveries.

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STATE AUDITOR'S NOTE TO DENR'S RESPONSE

The Office of the State Auditor provided a draft copy of this report to DENR management. Consistent with our standard practice, we have included DENR's response to our findings and recommendations in this report. DENR agreed with the report's recommendations and stated that it has initiated both disciplinary and corrective action. However, DENR's response to the report's findings includes certain statements or implications that, in our opinion, are misleading or inaccurate.

In its response, DENR states "*all companies* [emphasis added] were paid on the same terms," implying that numerous companies provided oyster shell transportation services. Our investigation determined that the Biology Supervisor's father-in-law was used almost exclusively for this particular type of oyster shell transportation. The father-in-law's company was paid \$209,001 over a seven-year period for hauling oyster shells. Only one other company was paid to haul oyster shells during that seven-year period. In February 2012, that company was paid \$1,351 to haul oyster shells from Washington, North Carolina to Hobucken.

North Carolina General Statute 14-234 - *Public Officers Benefitting from Public Contracts* states in part, "*No public officer or employee who is involved in making or administering a contract on behalf of a public agency may derive a direct benefit from the contract...*" DENR's response acknowledges that the Biology Supervisor's spouse is the president of the company that subcontracted the hauling of oyster shells. Our investigation determined that the subcontracting company was managed and controlled by the Biology Supervisor's father-in-law. The father-in-law said he provided a \$5,000 payment (from the subcontracting company) to the Biology Supervisor's spouse to cover expenses associated with a family vacation to Disney World. The father-in-law also said there may have been other small payments from the subcontracting company to the Biology Supervisor's spouse. In our opinion, the \$5,000 payment (and any other payments) represents a direct benefit derived from the procurement of oyster shell transportation. Therefore, the nearly exclusive use of family-owned businesses for the transportation of oyster shells is indicative of self-dealing and may represent a violation of North Carolina General Statute 14-234.

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North Carolina Department of Environment and Natural Resources

Beverly Eaves Perdue
Governor

Dee Freeman
Secretary

December 3, 2012

Beth A. Wood, CPA
State Auditor
2 S. Salisbury Street
20601 Mail Service Center Raleigh, NC 27699-0601

Re: Investigative Report – North Carolina Department of Environment and Natural Resources,
Division of Marine Fisheries

Dear Ms. Wood:

Your investigative staff has shared with us a draft of the investigative report referenced above, and I am now submitting on behalf of the Department our response to the findings and recommendations contained in the report. Your staff reported to us that our employees have been fully cooperative with your investigation, and we likewise appreciate the professionalism of your staff in this matter.

Please let me know if you need any additional information about this matter.

Sincerely,

David Knight
Assistant Secretary for Natural Resources

DENR's Response to Findings in the Investigative Report

The majority of the deficiencies discussed in the Investigative Report were the result of existing policies not being followed (rather than a lack of appropriate policies). The subject supervisor did not institute the use of his father-in-law's company for the transport of shells (the practice began several years before his promotion). He failed to recuse himself from dealing with his father-in-law's company. There is no indication that his father-in-law's company was given preferential rates or terms.

The direct purchase of shell transport services (without bidding) discussed in the Investigative Report, which resulted from a misunderstanding (over 20 years ago) about a special purchasing delegation which began in the early 1950s, has been corrected.¹ However, it is important to note, as the Investigative staff reported, that there is no indication that these practices resulted in DENR overpaying for transportation services, either generally or to the subject company in particular. All companies were paid on the same terms, which was the going rate paid by DOT in the area for comparable hauling. Although the father-in-law's company was the predominant hauler used, that circumstance predated the subject supervisor's promotion and arose from a shortage of willing haulers generally. The problem was finding enough such haulers on a regular and dependable basis, with sporadic demand. Assisting vendors (many of whom are unfamiliar with state purchasing technical procedures) with preparing invoices was likewise a long-

¹ Recent guidance from the state Division of Purchase and Contract, recognizing the market conditions for shell transport have the same constraints as the market for shells generally, has extended the special delegation to include transport.

standing, albeit improper, practice, and there was again no indication of abuse or disadvantage to the state. That practice was also discontinued.

The Investigative report states that the father-in-law's company "subcontracted" some shell transport work to a second company (also operated by the father-in-law), which he claims is 50% owned by the subject supervisor's wife. The supervisor denied knowledge of such ownership, and there are no corporate records available either to DENR or the Investigative staff detailing the ownership holdings. The only payment to the supervisor or his wife found by the Investigative staff was one check in the amount of \$5,000 paid by the second company to the supervisor's wife (who is the corporate president of that company) for reimbursement of expenses. The supervisor has repaid that amount. DENR does not believe that a violation of NCGS 14-234 has been shown, since, even if the wife is an owner of more than 10% of the second company, DENR never contracted with that company nor made any payments to that company.

DENR's Response to Recommendations of the Investigative Report

1. DENR agrees with the recommendation in Section 1. DMF has a clear policy that governs conflicts and requires disclosure. *See* DMF Policy manual, ADM-7, http://www.ncfisheries.net/insidefisheries/PublicRelations/NCDMF_Policy_Manual2011.pdf and DENR's Disciplinary Action Guidelines. http://portal.ncdenr.org/c/document_library/get_file?uuid=577522d1-d36f-44ab-bf0d-77b2a2373581&groupId=38331
In light of the Investigative Report findings, appropriate disciplinary action has already been initiated.

2. DENR agrees with the Investigative recommendation in Section 2 in its entirety. In addition, prior to receiving the draft Investigative report, DENR had met with the Department of Administration to request additional guidance on acceptable purchasing practices for the unique oyster rehabilitation program. That guidance was received on November 21, and will be implemented going forward.
3. DENR agrees with the recommendation in Section 3 that it should ensure that accounts payable policies and procedures are followed, and that DENR should not create invoices for vendors. DENR has already implemented the changes recommended and discussed above. All employees – not just the supervisor – have been instructed not to assist vendors in creating invoices.

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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This investigation required 716 hours at an approximate cost of \$50,616. The cost represents 0.16% of the \$31,865,282 expended in fiscal year 2012 by the Department of Environment and Natural Resources, Division of Marine Fisheries.