



March 29, 2016

Mr. K. Earle Powell  
Director, Legislative Audit Council  
1331 Elmwood, Suite 315  
Columbia, SC 29201

Dear Director Powell:

SCDOT would like to thank the auditors at the Legislative Audit Council (LAC), its Financial Audit consultants Scott & Company, and the South Carolina Department of Transportation (SCDOT) Team for their efforts to thoroughly research, review and analyze the Agency's operations. SCDOT is a very large and complex agency, as evidenced by the sheer size and time dedicated to producing this review. We appreciate the opportunity to respond and provide information from the perspectives of both the SCDOT Management Team and the Commission. Attached is SCDOT's response to the LAC's Draft Review dated March 28, 2016.

SCDOT agrees with many of the recommended improvements identified by the LAC and plans to utilize the review as an opportunity for improving the operations of the Agency. However, there are some differences of opinion between LAC and SCDOT on the interpretation of Act 114 and the regulations that were promulgated. SCDOT believes it has complied with the Act and the regulations that the General Assembly approved in 2008. SCDOT has utilized the regulations as the basis for its current operating procedures of producing project lists to align with project funding categories and providing mechanisms for the Commission to advance projects. We welcome dialogue on this very important and complex topic and are receptive to discussing modifications that would enhance the process and the Agency's transparency.

Finally, SCDOT appreciates the LAC recognizing the difficulty of the governance structure that the Agency has been operating under since 2007, the broken financial model that has not kept pace with escalating costs, and the redirection of road and bridge money away from SCDOT and its core priorities. This approach for the funding and management of the Nation's fourth largest state-owned highway system has led us to the crossroads our State faces today.

Respectfully Submitted,

Signature Redacted

Christy A. Hall, P.E.  
Secretary of Transportation

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James M. Wooten  
Chairman, SCDOT Commission

Attachment

## SCDOT Management Team Response

As the new Secretary of Transportation, I am especially appreciative of the team's efforts to identify areas of opportunity for improvement as well as to review several topics of frequent concern regarding SCDOT. Since my appointment, I have articulated a vision for a strong and effective DOT, where a hard-working, ethical and professional team earns the trust of the citizens of South Carolina. In order to achieve this vision, the organization must improve its transparency, responsiveness and migrate towards a performance based management organization that measures results. Quite frankly, the Agency has struggled for years with effectively communicating and, in particular, providing easy to use information that must be extracted from mounds of data and concepts that are highly technical in nature.

SCDOT's Management Team intends to use this review as a road map to assist the Agency in improving its operations. SCDOT concurs with 123 of the 148 agency-specific recommendations by the LAC. We will add these items to our other management initiatives which I had previously identified as our first four focus areas for improvement, which are:

1. Stabilize the Workforce and Leadership Team,
2. Improve Project Delivery,
3. Simplify Messaging and Provide Visibility into the Organization and
4. Strengthen our Procurement Processes for Consultants.

However, in order to position the Agency for success on implementing all of these much needed improvements and affect long-term, sustainable change for the organization, the issue of governance must be resolved. Without the governance issue resolved, it will be nearly impossible to set clear priorities, instill effective accountability and finally resolve the question of where the buck stops for the organization. According to the LAC, the current governance arrangement creates confusion as to who governs the department and undermines the authority of both the Secretary and the Commission. Leaving this issue unaddressed will hinder the Agency's ability to manage the change necessary for SCDOT to be in compliance with the LAC's recommendations.

SCDOT's Management Team notes the following 4 major themes within this LAC review:

1. ***No financial mismanagement was identified at the Agency.***
2. ***The prioritization and ranking processes associated with Act 114 are complex.***
3. ***SCDOT is tasked with managing a transportation system in a state of disrepair with revenues that have not kept pace with rising construction costs.***
4. ***Unclear lines of authority and turnover have led to shifting or unstable priorities.***

**No financial mismanagement was identified at the Agency.**

The Agency must maximize every dollar our citizens provide to operate and maintain the road and bridge network owned by the State. Therefore, SCDOT has to ensure that funds are used in accordance with their intended purpose. The Agency has received clean financial and procurement audits for the last several years. Additionally, this LAC review found no indication of unnecessary salary increases, no deficient items on vendor payments that would have caused penalties or missed opportunities for interest, no issues with contractor change orders and no issues on contract negotiations. The LAC commented that the fluctuating costs in administrative expenses have been outside of the control of the Agency. The LAC also notes that SCDOT has adhered to what the Agency believes to be the intent for the Non-Federal Aid account funds and has not spent those dollars on administrative expenses. Additionally, SCDOT's effort to implement a bright-line rule on post-employment was also recognized in a positive manner by the LAC.

The LAC further reports that SCDOT's costs are comparable to its neighboring states and that there is no clear evidence that the County Transportation Committees (CTCs) or county government can complete similar work as SCDOT at a lower cost. With regard to the rates charged to the CTCs for work SCDOT performs, SCDOT did complete an analysis of the fee structure and determined that the rates charged do not actually cover the cost for SCDOT to deliver those services.

Even with all of the positives noted above, there is still room for improvement. For example, this LAC review identified SCDOT's challenges with its efforts to engage in techniques to reduce costs for reconstructing segments of roadways where complete rebuilding from the foundation layer up is necessary due to years of deferred maintenance.

The LAC review also summarized the issues associated with the I-85 project in Spartanburg County, where the pavement rehabilitation for 10 miles in both the northbound and southbound directions had to be terminated as a result of decaying pavement in the underlying layers. This was an unprecedented event in South Carolina. Unfortunately, this situation is an example of increased costs associated with the continued decay of pavements and the lack of resources necessary to address the pavements on accepted industry resurfacing cycles. As a result of this experience on I-85, SCDOT is coring all pavements on the Interstate system prior to initiating a pavement project so the deterioration level of the underlying pavement layers can be determined. Furthermore, the Agency has identified two other major sections of the Interstate system that are exhibiting similar conditions of decayed underlying support layers and therefore the budgets for those respective projects will have to be increased to address the years of deferred maintenance.

The LAC review also points out two items where SCDOT was involved in responding to local requests and coordination regarding bridges: the inspection of privately-owned bridges in Woodside Plantation in Aiken County and the replacement of the S.C. 41 Bridge over the Wando River in Charleston/Berkeley Counties. The decisions regarding both of these items were made under previous administrations; however, it is important to note in both of these instances that SCDOT staff was responding to constituent requests and local involvement regarding important transportation issues.

According to S.C. Code Section 57-3-110(7), SCDOT has the duty to "instruct, assist and cooperate" with local governments in street and highway matters "when requested to do so" and "supervise or furnish engineering supervision for the construction and improvement of roads and bridges, provided such duties do not impair the attention to be given to the highways in the state highway system." SCDOT recognizes

that it is generally considered the transportation experts for the State of South Carolina and that there may be times when local governments will request assistance with transportation-related matters especially regarding safety. In order to remove the appearance of impropriety, we concur with the LAC's recommendation regarding the implementation of a policy to require a request for assistance from a local government entity for potential work to be performed outside of the Department's right-of-way to be submitted in writing and to include the purpose and need of the request.

The issue surrounding the replacement of the structurally deficient and functionally obsolete S.C. 41 Bridge over the Wando River was the result of SCDOT following S.C. Code of Laws Sections 57-5-820 and 57-5-830 that require the approval of a local municipality for projects within the municipal boundary. In this instance, the Town of Mount Pleasant did not want a bridge that was higher than 25-35 feet and the U.S. Coast Guard advised that they would not agree to a bridge less than 55 feet in height or a moveable bridge. After numerous attempts to resolve the issue, engineering staff determined that the only possible path forward to replace a seriously stressed bridge and achieve the required approvals was to replace the existing structure with an in-kind moveable bridge at a higher cost. While the issue was eventually resolved by the Town of Mt. Pleasant agreeing to a 55 foot high bridge, it took eight years to receive municipal consent. The Agency believes that the General Assembly should revisit the requirements for municipal consent on bridge replacement projects in order to allow the Agency to move forward with implementing these safety critical projects.

### **The prioritization and ranking processes associated with Act 114 are complex.**

Act 114 became law on June 27, 2007, which required promulgation of regulations related to the prioritization of projects requirement of the Act. The fact that the Legislature directed SCDOT to promulgate regulations to implement the prioritization process indicates that the Legislature recognized that the process would be complicated and required the input of SCDOT staff and expertise. As recognized by the South Carolina Supreme Court in numerous cases, a statute declares the legislative policy, establishes primary standards for carrying it out, and delegates to administrative agencies the duty of "filling in the details" through the rule making process. The Legislatively mandated procedures for promulgating regulations requires publication of a notice of drafting in the State Register, publication of the proposed regulations in the State Register with opportunity to comment and a public hearing and submission to the Legislature for approval.

SCDOT diligently undertook the development of a new prioritization process as soon as Act 114 was enacted and delivered the proposed regulations to the Legislature in January 2008. In April of 2008, the proposed regulations were considered by the Legislature. Most of the proposed regulations were approved without objection; however, there were some specific amendment adjustments requested before the regulations would be reported out to the full Senate. Ultimately, the regulations were approved by the Legislature in June 27, 2008.

LAC disagrees with SCDOT's prioritization process which provides for multiple project lists, not a single list. However, the approved regulations provide the basis for using multiple lists. For example, the title of S. C. Reg. 63-10(C) is "Project Priority Lists." S. C. Reg. 63-10(C)(1) provides that "The Commission shall establish statewide project priority lists ...." SCDOT is of the opinion that the law and regulations never intended to prescribe a process requiring the prioritization of projects of varying categories, such as an interstate

capacity project versus a bridge project, or a resurfacing project versus a safety project, into a single statewide project list.

It seems as though there is confusion regarding how the process actually works. At a high level, the current process is a two-step process:

- Step 1 involves the SCDOT Commission establishing the funding allocation amounts to the various, distinct, project categories. These categories are established in accordance with the intended purpose of the various types of projects such as bridges, resurfacing, safety, etc.
- Step 2 involves the ranking of projects within those categories.

The LAC suggests that SCDOT did not consider all the Act 114 criteria for each project category. SCDOT did consider all criteria but determined that some criteria were not relevant to every category. When SCDOT promulgated the project prioritization regulations, it stated that only "relevant criteria" would be applied and this provision of the regulations was approved. In some cases, federal guidelines mandate the criteria used for rankings.

SCDOT disagrees with the suggestion by the LAC that the Agency should have a single list and that the Agency should simply implement projects straight down that list, with no variation from the ranking order or distribution based on a county basis. Using the LAC's proposed approach of a single list could conceivably mean beginning with the top ranked interchange improvement project, the I-20/I-26 interchange in Columbia, which is estimated at \$1-1.5 Billion in cost. This single project is equivalent to SCDOT's entire annual road and bridge budget.

Additionally, the single list concept could very easily produce a situation where some counties in the State receive little to no SCDOT road or bridge funded projects for years, even though taxpayers in those counties are contributing to the funding mechanism for SCDOT. SCDOT identified this as a real and legitimate issue when the Agency initially developed statewide ranking lists for paving projects and found that many small rural counties received little or no funding from one of the paving categories for two years in a row.

Similarly, the Agency does not believe it would be effectively serving our citizens if we allowed planned bridge projects in the State to grind to a halt simply because a project ahead of them in the rankings was held up, such as the previously discussed S.C. 41 Bridge project that was held up for eight years. South Carolina simply cannot afford to wait in situations like this.

S.C. Reg. 63-10(C)(2) specifically provides for the ability of the Commission to deviate from the list based on significant financial or engineering considerations, delayed permitting, *force majeure*, pending legal actions directly related to the proposed project, federal law or regulation or economic growth.

We welcome dialogue on this very important topic and are certainly willing to reconsider our current processes. As part of the Agency's efforts to implement a performance-based management program, we are already reviewing our processes and are moving forward to revise a few of our practices to align better with the federal program requirements.

We also recognize that a process of this complexity can be difficult to explain to the public in a transparent way. The Agency will develop a plan to simplify messaging on prioritization and provide access to information on what projects are being funded in order to gain the trust of our citizens.

**SCDOT is tasked with managing a transportation system in a state of disrepair with revenues that have not kept pace with rising construction costs.**

According to the LAC, SCDOT's total revenues only increased 12% or \$160M over the past 10 years, which includes the Act 98 pass-through money for the South Carolina Transportation Infrastructure Bank (SIB). Meanwhile, the Agency has been battling 34% inflation over that same time period. It is also important to recognize that General Funds, which had been allocated to SCDOT in this time frame, were typically earmarked for specific projects or certain activities.

The LAC further notes that 25% of the Agency's revenues are being diverted or allocated to others such as the SIB, CTCs, Metropolitan Planning Organizations (MPOs), Council of Governments (COGs) and debt payments. It's easy to see how there could be confusion regarding highway policy in this State. One could easily argue that there are at least four other DOTs in the State that are resourced in disparate ways, with differing priorities. The unintended consequence of South Carolina's current funding approach is the creation of bookends: (1) one bookend has funding directed to the high volume, high priority Interstate system by SCDOT's Federal Aid Program and the SIB Interstate Projects; and (2) the other bookend has funding directed to the low volume, local or neighborhood streets by the CTCs and SCDOT's Non-Federal Aid Program. This bookend approach, combined with 25% of the Agency's revenues being diverted and the overall decline in purchasing power, has limited SCDOT's ability to address its core priorities. As a result, the Primary system which carries half of our traffic and serves a vital role in the movement of people and freight in both our urban and rural communities has significantly eroded in condition.

The LAC notes that as pavements continue to decline the cost of repairs go up exponentially. SCDOT utilizes a blended approach for pavement treatments, based on engineering judgment and pavement condition. In order to ensure maximum optimization of available funds, we agree with the LAC that the Agency should increase the frequency that it collects pavement condition data and further refine our analysis and predictive modeling of pavement conditions in order to ensure that the timing of preservation and rehabilitation treatments are proper. However, we disagree that engineering judgment should be excluded from the process. The Agency's local engineers have first-hand knowledge of real-time road conditions, proposed construction (such as new schools, hospitals, economic development sites, etc.) and citizen complaints regarding the existing road network. Excluding them from the process would devalue the voice of the local community in the selection of projects.

The investment needs of the State's infrastructure network are tremendous. South Carolina has the 4<sup>th</sup> largest state-owned transportation system in the Nation and the fatality rate on our roadways has been about 50% higher than the national rate. Also, according to the LAC, SCDOT is more dependent on both federal funding and motor fuel taxes than the national average. The Federal Program represents about half of our total revenues and drives a lot of what the Agency does. The LAC also states that: "Of all states, South Carolina dedicates the smallest amount of revenue to state roads relative to the size of the system and the amount of traffic it carries. . . Even in a comparison with seven other Southeastern states, South Carolina's investment per lane mile is 66% lower than the regional average. . . ." This funding formula for South Carolina has led to a state-maintained system that is severely decayed and projected to erode even further.

Failure to address the funding needs for our roads will likely jeopardize our ability to be competitive in economic development projects and serve the basic needs of our citizens. In recognition that the \$1.47 Billion annual gap for road and bridge funding as identified through the last two multimodal plans was for

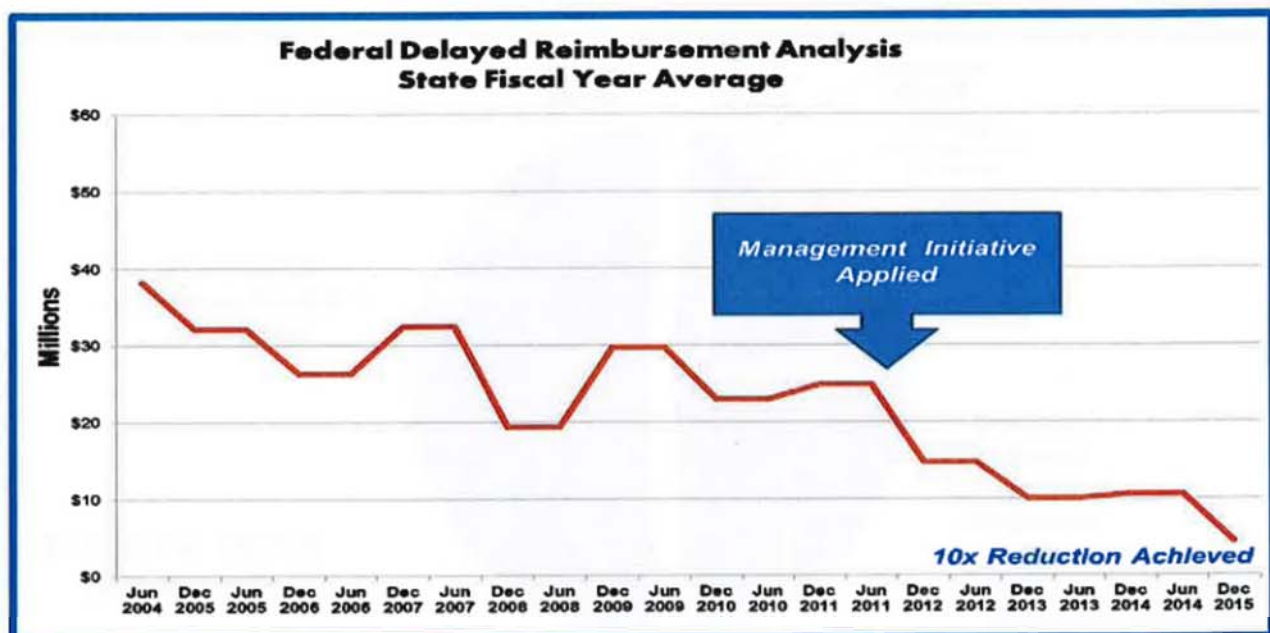
an unachievable, near-perfect transportation network, SCDOT's Management Team developed several investment scenarios with attainable goals. These investment scenarios were developed to focus on a "Fix-it-First" approach and also introduce performance targets to draw the connection between resources and outcomes.

The annual funding need is actually increasing with each year that SCDOT does not receive additional funding. While there may be a temptation to issue debt in order to address these significant funding needs regarding the condition of the State system, the Agency would not recommend issuing bonds or incurring any other indebtedness for addressing paving projects. Instead, the responsible use of debt would be for larger capacity type projects or bridge replacement projects.

SCDOT still carries \$525M in debt associated with General Obligation Highway Bonds and other significant projects financed through the SIB. While the Agency has limited bonding capacity available based on current resourcing levels, SCDOT has been able to cut its debt in half since 2006. Additionally, the LAC recognized that the Agency has aggressively managed its bond indebtedness, which has resulted in significant savings of approximately \$41M in bond refundings over the recent years.

As described by the LAC, SCDOT has had a renewed focus on cash flow management since its financial crisis of 2011. SCDOT's monthly financial reports reflect that the Agency typically has well over \$1.5 Billion in contractual commitments in force at any one time, with most of those contracts structured on a reimbursement basis. This means that SCDOT must utilize state cash on hand to pay for the project up front and then request reimbursements for appropriate portions. During the peak summer construction season, SCDOT contracts can have a peak monthly cash demand on state dollars up front of over \$100 Million. Therefore, a cash balance between \$200 - \$300 Million would represent two to three months of operating expenses in the event of a disruption of the revenue streams at either the State or Federal level currently flowing into the Agency.

As an example of the Agency's modifications of its financial management practices, SCDOT's Management Team places an emphasis on ensuring that the Agency properly receives all eligible federal reimbursements in a timely manner: the results of which are shown in the below chart.



**Unclear lines of authority and turnover have led to shifting or unstable priorities.**

The LAC review documents that SCDOT has struggled with unclear lines of authority and turnover leading to fluctuating priorities, inconsistent policies and a lack of focus on our core mission. The items discussed in the review regarding governance, internal audit functions, Strategic Plan, data management and retention are all evidence of these problems.

The current Management Team of SCDOT has accepted the challenge of refocusing the Agency on our core mission, improving transparency, developing and implementing performance measures, improving the reliability and responsiveness of the Agency and making positive changes within the organization. However, the effectiveness of the Management Team’s efforts will be hampered by the cloud that continues to hang over the Agency regarding governance and lines of authority.

Additionally, the relationship between the Commission, Internal Audit and the Management Team is not conducive to improving program performance and operations, reducing costs, facilitating prompt decision making, and ensuring public accountability.

In order to make the Agency more transparent and bring more accountability to the organization, the Management Team has created and published reports not only to provide visibility into certain management metrics, but also to set the tone for the organization. The latest of these efforts is the Monthly Management Report which is posted on SCDOT’s webpage and presented to the Commission at its monthly public meeting. This report is structured to align with the focus areas and as such details accomplishments, workforce trends, project delivery indicators, social media snapshots and consultant utilization. SCDOT also posts on its website detailed information relative to consultant solicitations, engagements and awarded work by firm. The vast majority of these contracts are procured on a qualification-based selection process, in accordance with federal requirements. Furthermore, SCDOT posts monthly on its website all bids received for road and bridge construction contracts.

Additionally, two years ago, SCDOT worked with the S.C. House of Representatives to revise the way it was presenting its budget and expenditures. The result of the new methodology is a much easier-to-understand budget, as shown below.





Over the past year, SCDOT has diligently worked to post its monthly expenditures based on this format on its webpage at [www.scdot.org/inside/spending.aspx](http://www.scdot.org/inside/spending.aspx). The expenditures report provides information in a statewide table, a SCDOT Engineering District table and provides the ability to drill down to an individual county level.

Prior to this new methodology, it was virtually impossible to determine with any great precision how much SCDOT was spending on maintenance versus widening projects unless the accounting definitions were utilized. For practical purposes, SCDOT defines maintenance as the repair and upkeep of the existing transportation system. It includes items such as the day-to-day activities our maintenance forces do in the field (mowing, pot hole patching, shoulder and ditch work), resurfacing, pavement preservation, pavement rehabilitation and reconstruction work and all bridge replacement projects.

Maintenance is a priority of the current Management Team as indicated in the investment scenarios prepared for the General Assembly this year. These scenarios all placed a high priority on improving the conditions of the existing road and bridge network. The SCDOT Team is dedicated and committed to serving the State's citizens. Our performance during and after the October 2015 record flooding event clearly demonstrates our ability to deliver top notch results, given good solid direction and resourcing.

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### **SCDOT Commission Response**

The SCDOT Commission thanks the LAC for the opportunity to respond and provide perspective on the findings of the most recent legislative audit. South Carolina needs a safe and reliable network of transportation corridors. The Commission believes an efficient well maintained network ensures a competitive advantage to our State in the recruitment of new industry and advancement of our tourism. These networks also allow existing industry an opportunity to grow. The Commission and the Agency should share a passion in achieving this goal with a statewide sense of purpose, and we believe it does.

The Commission agrees the General Assembly should provide clarity to the current structure. The Commission believes the best structure is one where the Commission sets policy and direction and is responsible for employing the Secretary, much as a vast majority of boards do. We believe the Commission should not be responsible for the selection of projects, contractors or the approval of their contracts. It is the responsibility of the Secretary of Transportation to develop, design, build and maintain the network. The Commission should approve an annual budget, a strategic operational plan and review the Department's performance relative to that budget and plan. It is the Secretary's responsibility to keep the Commission informed in a manner that allows it to measure the effectiveness of the department in delivery of projects and meeting its annual strategic goals and objectives.

The Commission believes that it plays an important role in providing oversight and direction to the Agency. Its makeup should consist of a nine (9) member Commission with one Commissioner from each Congressional District and two members at large. The Commissioners should select its Chairperson on an annual basis. This would ensure the Chairperson had some experience and knowledge of the overall workings of the Commission and the Agency prior to his or her service. Each Commissioner's term should be six (6) years with an additional six (6) year appointment available. No Commissioner should serve more than 12 years.

The Commission should select a highly qualified individual with the experience, knowledge and leadership abilities to serve as Secretary of Transportation. The duties of the Secretary should at a minimum include the following:

- Serve as the Chief Executive Officer (CEO)
- Employ and manage a team of highly qualified individuals to assist in the day to day operations of the Agency, including the Deputy Secretaries, legal staff and any other personnel deemed necessary in carrying out the duties of the Secretary.
- Represent the SCDOT in dealings with federal, state and local governments and special purpose districts.
- Prepare an annual budget and operational plan with defined goals and objectives to be approved by the Commission.
- Direct the implementation of a Statewide Transportation Improvement Program (STIP) with a 5-year Program to be approved by the Commission on a biannual basis.
- Develop a ranking system to quantify inclusion of a project into the STIP.
- Direct the implementation of a statewide Mass Transit Plan.
- Approve all construction, consulting and procurement contracts.
- Approve all encroachment permits
- Approve all installation of new signals, curb cuts on primary roads, bike lanes and walking trails
- Approve routine operation, maintenance and emergency repair requests and needs.
- Approve additions and deletions of roads in the state highway system
- Approve the sale of all surplus properties.
- Report at a minimum of six (6) times a year to the Commission on the status of the SCDOT in meeting its goals, objectives and budget compliance. This includes the preparation of management reports that can quantify and measure operational performance of the SCDOT and the State transportation system.

The Commission believes it should approve all projects included in the STIP. The Commission agrees the prioritization and selection of projects should follow the guidelines outlined in Act 114. The Commission believes prioritization rankings are quantifiable and can only meet the Agency's objectives and goals if categorized by project type and funding sources. The Commission disagrees that there should be one list because this will be confusing at best and extremely difficult to justify given the vast differences between types of projects. The report suggests maintenance projects be prioritized. The Commission believes routine maintenance projects cannot be prioritized. The report also states the SCDOT should minimize spending on capacity projects. The Commission strongly disagrees. To ignore or reduce funding for capacity projects would effectively increase maintenance costs and further decay the road's foundation.

The Commission agrees the Agency is responsible for too many of the center lane miles throughout the State. Many of the secondary roads that provide connectivity only within their respective county should be transferred to that county or to municipalities within the county. The CTC funding program is a path the General Assembly can utilize to transfer a proportional share of State funding to maintain this network. However, the Commission feels the CTC must be carefully monitored to insure proper and expedient utilization of funding.

The Commission believes the MPO and COG programs should have planning authority within their respective areas. The Commission believes the TMAs should be funded based on Federal guidelines. Additional funding for planning purposes to the remaining MPOs and COGs should also be available.

Project selection under these programs should be submitted to the Agency and ranked based on Act 114 criteria. Inclusion of a project into the STIP must meet Commission approval.

Financial resources to carry out the responsibilities of the Agency are empowered in the State Legislature and reimbursements from Federal sources. The Commission and The Secretary of Transportation have a fiduciary responsibility to ensure these resources are spent efficiently and for the purpose for which they are intended. The Audit identifies a relatively flat level of State funding over the past eight years. The Commission agrees with the finding that revenue sources are not growing at a pace to cover increasing costs due to inflation, as well as the growth of the system. The Commission believes these findings validate the need for additional state funding. The State Legislature should ensure the Agency has sufficient resources to carry out its mission.

The Commission agrees the internal audit function has been ineffective. The Commission believes the Chief Internal Auditor should be reportable to a defined body to ensure compliance with its mission, duties and responsibilities. Any signs of fraud or unlawful acts by employees of the Agency should be immediately turned over to an investigator or compliance officer located in the Office of Chief Counsel. The Commission agrees that OCIA needs independence to adequately perform internal audit duties, and believes that it has that independence. The Commission agrees that OCIA should complete annual department-wide risk assessments. The Commission agrees each audit should be timely and conducted according to IIA's standards and guidance for internal auditors.