
Secretary of State

State of Oregon

DEPARTMENT OF ADMINISTRATIVE SERVICES

Printer Contract

July 18, 1994, to July 17, 1997



Audits Division

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Audits Division

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At the request of the Department of Administrative Services, we audited prices charged to the state under Price Agreement 4315, a printer contract with R & D Industries, Inc. This contract, for printers, cartridges and related accessories, was effective from July 18, 1994, through July 17, 1997. The purpose of this audit was to determine whether the vendor charged appropriate prices based on contractual terms.

We found that, throughout the contract period, R & D Industries, Inc. charged higher prices for certain items than the rate established by contract. As a result, the state and other government agencies paid more for printers, cartridges, and accessories than they would have if prices had been charged according to contract terms. Total overcharges during the three-year contract period ranged from \$599,000 to \$635,000. (This range results from gaps in the records provided to us by R & D Industries, Inc.) Overcharges related to state agencies ranged from \$422,000 to \$454,000; the remaining amounts were paid by other non-state public agencies authorized to buy off the state's price agreement.

In conducting this audit, we reviewed contractual terms in the price agreement. We reviewed relevant purchase, sales, and invoice records of R & D Industries, Inc. We also reviewed selected purchase records of several state agencies. We interviewed management and staff of R & D Industries, Inc. and the Department of Administrative Services' Transportation, Purchasing and Print Services Division and other relevant state agencies.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork Completion Date:
May 20, 1998

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SUMMARY

BACKGROUND

Department of Administrative Services (department) asked Oregon Audits Division to conduct an audit of Price Agreement 4315. The department had received allegations that the vendor, R & D Industries, Inc. (RDI), was not charging prices in accordance with contract terms. RDI proposed and the state accepted a price formula based on “cost plus 1.75 percent.” The bid proposal also stated there would be additional discounts to educational institutions for purchases of certain specified items.

Price Agreement 4315 allowed state agencies to purchase Hewlett-Packard printers, accessories and cartridges off of the statewide contract without having to bid each separate purchase. The contract, effective from July 18, 1994, through July 17, 1997, was also available to participating, non-state public agencies, as authorized by the department.

AUDIT PURPOSE

The purpose of the audit was to determine whether the vendor charged appropriate prices based on contractual terms.

AUDIT RESULTS

RDI charged prices for certain items in excess of the rates established in the contract. This occurred throughout the three-year contract period. As a result, state and other non-state public agencies paid more for printers, accessories and cartridges than they would have if prices had been charged in accordance with contract terms. Total overcharges during this three-year period ranged from \$599,000 to \$635,000, of which \$422,000 to \$454,000 related to purchases made by state agencies. The remaining \$177,000 to \$181,000 was paid by other agencies using the state’s price agreement. Due to gaps in the records provided by RDI, the overcharge was calculated in a range.

RDI did not consistently reduce prices charged to educational institutions for the educational rebates given by Hewlett Packard for specific equipment models at various times. RDI’s records show price agreement sales to state and other agencies of \$107,000 for items that were not included in the price agreement.

AGENCY'S RESPONSE The Department of Administrative Services concurred with the findings.

INTRODUCTION

BACKGROUND

In June 1997, the Transportation, Purchasing and Print Services Division of the Department of Administrative Services (department) received allegations that a vendor, R & D Industries, Inc. (RDI) of Beaverton, Oregon, was not charging appropriate prices for printers as set forth in its contract with the state. The department asked for an audit of this contract, Price Agreement 4315.

The department's Transportation, Purchasing and Print Services Division (division) is responsible for directing multi-agency purchases of products and services. Through its Purchasing Operations program, the division serves as the central purchasing authority for state government. The employees in this program are responsible for administering goods and services contracts, authorized by Oregon Revised Statutes Chapter 279, including price agreement contracts.

The division establishes price agreements so that state agencies and participating public agencies can take advantage of the volume purchasing power of the state as a whole, reduce paper work, achieve continuity of product availability, secure a source of supply, reduce inventory, and reduce lead time for ordering. State agencies and other non-state public agencies buying from state price agreements do not have to solicit individual bids or price quotes from vendors. Non-state public agencies sign a cooperative purchasing agreement with the division to participate in the Oregon Cooperative Purchasing Program and buy through state contracts.

Price Agreement 4315, effective July 18, 1994, through July 17, 1997, was a contract for Hewlett-Packard laser, ink or ink transfer printers and cartridges. Also included were related accessories such as network interfaces, paper trays and memory upgrades. The prices proposed by RDI and agreed to in the 1994-1997 contract were based on a "cost plus 1.75 percent" formula. Sales for the three-year period ending July 17, 1997, totaled \$11.8 million, according to the division's information.

RDI also held a similar contract for a prior three-year period from June 1, 1990, through May 31, 1993. We have not audited transactions of this earlier price agreement. It also included a price formula of a 41 percent discount off the retail price.

The division did not have a price agreement in effect for printers and related items in the interim period between the two RDI contracts.

SCOPE AND METHODOLOGY

This audit encompasses purchase transactions under Price Agreement 4315 from July 1994 through July 1997. We did not audit transactions of the earlier RDI price agreement from June 1, 1990, through May 31, 1993.

In performing the audit, we obtained purchase information from several state agencies to provide a basis for comparison to RDI records. Purchases using a price agreement are executed through “contract release orders.” Thus, we selected some of these contract release orders for price verification to RDI data. We obtained sales order worksheets containing cost and price data from RDI’s Beaverton office. From RDI’s corporate office in Bellevue, Washington, we obtained original manufacturer’s invoices to verify cost data reflected on the sales order worksheets. From the Bellevue office, we also obtained RDI’s detailed sales information in electronic format for the period January 1995 through July 1997. However, RDI officials stated that the company could not provide July through December 1994 sales detail for price agreement transactions.

In addition to examining records as described above, we interviewed personnel of the division and the state agencies from which we obtained purchase information. We also interviewed RDI personnel.

We conducted this audit in accordance with generally accepted government auditing standards. We limited our work to those areas specified in this section of the report.

AUDIT RESULTS

OVERCHARGES

Throughout the three-year period of the contract ending July 17, 1997, R & D Industries, Inc. (RDI) charged prices for certain contract items in excess of the amounts established by Price Agreement 4315. As a result, state and other non-state public agencies paid more for printers, accessories and cartridges than they would have if the contractual price formula had been applied. Total overcharges ranged from \$599,000 to \$635,000, of which \$422,000 to \$454,000 related to state agencies' purchases. The remaining \$177,000 to \$181,000 were purchases by other non-state public agencies using the contract. The overcharges were calculated in a range due to gaps in the detail records provided to us by RDI.

Cost Basis

RDI's proposal and the subsequent price agreement established a pricing formula of "cost plus 1.75 percent." The price agreement required RDI's invoices to "reflect prices in effect on the date the contract release order was written."

Through discussions with RDI management, it became apparent that RDI did not determine cost according to the contract terms. Often, RDI's employees did not purchase products from manufacturers on the same day they received a contract release order. Instead, items were usually provided from RDI's on-hand supply. Beginning in March 1997, rather than buying direct from the manufacturer, RDI was purchasing from a distributor. This method allowed the distributor to ship orders directly to the customer, rather than to RDI for subsequent delivery to the customer.

In both cases, RDI indicated that its cost on the sales order worksheets was based on the cost of the product used to fill the contract release orders, rather than the cost on the day the contract release orders were written. At the time of an order, the RDI sales office identified the cost of on-hand stock from RDI's computerized system or checked the manufacturer's price for items to be ordered, then quoted the price for the purchasing agency. Sales order worksheets, prepared by the

sales person at the time of each purchase, documented this cost and the price being charged.

Because we established that RDI did not determine cost according to the contract terms, we used RDI's price to purchase the ordered item or the most recent previous purchase of the item when we examined manufacturers' invoices to verify RDI's recorded cost for a specific item sold to the state. For purposes of this audit we used RDI's recorded cost for each item sold under the price agreement.

Determining Overcharges

We identified contract release orders from various state agencies for comparison to RDI records. RDI's Beaverton office provided sales order worksheets that reflected both cost and price data for each individual item on a given contract release order. We found that the prices noted on the sales order worksheets generally agreed with those reflected on state agencies' records. However, the cost data clearly indicated that RDI was not applying the contract pricing terms, as shown in Example 1 on page 5. For example, had the contract terms of cost plus 1.75 percent been followed, the LaserJet 5Si would have been priced at \$2,249.24, \$364.33 less than the price charged. Example 2 on page 6 shows cost/price comparisons for the items listed in Example 1.

EXAMPLE 2

	Cost	Contract Price (Cost plus 1.75%)	Actual Price	Overcharge	Percent Overcharge
LaserJet 5Si	\$2,210.56	\$2,249.24	\$2,613.57	\$ 364.33	16%
JetDirect Card	\$ 444.14	\$ 451.91	\$ 453.48	\$ 1.57	Less than 1%
4M SIMM (memory)	\$ 19.00	\$ 19.33	\$ 102.50	\$ 83.17	430%
DeskJet 820 Cxi	\$ 260.67	\$ 265.23	\$ 327.22	\$ 61.99	23%

To verify RDI's cost, we visited its Bellevue, Washington corporate office where the original manufacturers' invoices are maintained. Our examination of manufacturers' invoices indicated that for 290 selected sales transactions, the recorded cost was accurate for 199 sales (69 percent) and within \$5 for 245 sales (84 percent). Therefore, the cost data recorded on the Beaverton office's sales order worksheets was consistent with RDI's described cost method.

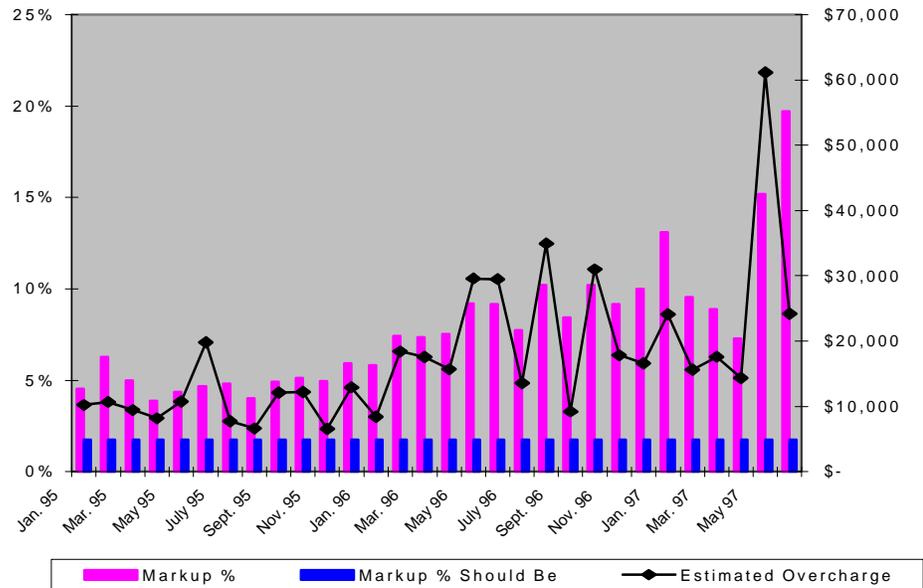
Cost data was also reflected in detailed price agreement sales data RDI provided in electronic format at our request. Based on our examination of the cost data, we determined the data in electronic format could be used to calculate total overcharges. However, the electronic data only included the period of January 1995 through July 1997. RDI officials explained that detailed sales data was not available for July through December 1994, the first six months of the contract period. Furthermore, the data provided for June and July 1997 appeared incomplete in comparison to both the previous monthly sales volumes and the quarterly report that included those months.

Included in this electronic data for November and December 1996, was RDI's "markup" for each item sold under the price agreement. Approximately 95 percent of the markup amounts shown in the RDI data for these two months were greater than the 1.75 percent markup agreed to in its contract with the state.

RDI also was required by the price agreement to provide quarterly sales data to the division. Using the electronic detailed sales information in conjunction with the quarterly sales reports, we estimated price agreement overcharges to be in the range of \$599,000 to \$635,000. These estimates, which were necessary due to gaps in the information RDI provided, use quarterly sales data for the months RDI did not provide electronic detailed data or did not provide complete data. Because we did not verify the quarterly sales reports, we relied on the audited electronic data in all months for which it was available and deemed reliable.

Further analysis of RDI's cost and pricing data showed that as the contract period elapsed, RDI's markup increased, ranging from a low of 3.9 percent in April 1995 to 19.7 percent by July 1997. Chart 1 compares the actual markup to the contract rate and shows the estimated overcharges in dollars.

CHART 1



Educational Rebates

We noted instances in which RDI received educational rebates from Hewlett-Packard for select items sold to schools and universities. However, some of these rebates, ranging from \$18 to \$177, were not passed on through reduced prices to the schools and universities that actually purchased the items.

The RDI bid proposal dated June 13, 1994, stated, “state accredited educational institutions will receive an additional discount for the following products” and listed specific models. Further, the contract required RDI to give the state the immediate benefit of any price decreases. The intent of this provision, as stated in the contract, was not to change the contractor’s profit margin but to take advantage of manufacturer’s price reductions. The educational rebates decreased RDI’s cost for these items; therefore, the benefit of the rebate should have been given to those educational institutions.

We have not calculated the total overcharge for these educational rebates. The educational rebates were for specific printers at various times. RDI’s records did not facilitate identifying when educational rebates occurred, and whether or not a given rebate was reflected in the educational institution’s purchase price.

Non-Contract Items

An additional \$107,000 of items were represented in RDI’s records as being sold under the price agreement that were not within the scope of the contract. Approximately \$81,000 of this amount related to state purchases; the remaining \$26,000 was for purchases by other non-state agencies. Most of the non-contract items were scanners.

State laws allow agencies to purchase non-contract items as long as purchasing laws are followed, including advertising and taking bids when required. We asked 13 selected state agencies whether the non-contract items they purchased were separately purchased, or whether these items were represented by RDI as being available under the price agreement. Of the 58 selected purchases totaling \$37,000, 30 items were contract release orders that specifically referenced Price Agreement 4315. Personnel at seven of the 10 agencies

making these purchases indicated that the agency buyers probably assumed the items were under the referenced price agreement. Personnel at the other agencies did not offer an explanation for referencing the price agreement when purchasing non-contract items. In one specific case, a scanner and document feeder were purchased after RDI indicated to the agency that the items would receive contract pricing.

RECOMMENDATIONS

We recommend the Department of Administrative Services seek recovery from R & D Industries, Inc. the overcharges related to Price Agreement 4315.

REPORT DISTRIBUTION

This report is a public record and is intended for the management of the Department of Administrative Services, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by officials and employees of the Department of Administrative Services' Transportation, Purchasing and Print Services Division and R & D Industries, Inc. during the course of this review were commendable and sincerely appreciated.

AUDIT TEAM

Sharron E. Walker, CPA, CFE - Deputy Director
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AGENCY'S RESPONSE TO THE AUDIT REPORT



Oregon

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December 10, 1998

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Dear Ms. Walker:

The Department of Administrative Services is pleased to respond to your recent audit report on the Printer Contract, Price Agreement 4315. We concur with your findings. As to your recommendations, we have had an initial conversation with the Department of Justice. This matter will be turned over to the Department of Justice for appropriate recovery actions.

We will keep you and your staff apprised of our progress on this recovery project.
Thank you for your assistance in this matter.

Sincerely,

Jon Yunker
Director

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This report is intended to promote
the best possible management of public resources.



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