



Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

Secretary of State Audit Report

Department of Administrative Services: Smart Buy Program Review

Summary

PURPOSE

Our audit objective was to determine whether there were opportunities for additional savings under the Smart Buy program through improved management practices. To accomplish our audit objective, we reviewed:

- the extent to which the Department of Administrative Services (department) had implemented at least one procurement strategy for each commodity category Silver Oak Partners, Inc. (Silver Oak) identified as having high savings potential;
- whether greater utilization of Smart Buy contracts during fiscal year 2006 would have led to significant additional savings; and
- state agencies' success at earning office supply rebates under the Smart Buy contract during fiscal year 2006.

BACKGROUND

Through the Smart Buy program, introduced in 2003, the department implemented various procurement strategies to improve the state's purchasing power. At the outset of the program, the department contracted with Silver Oak to, among other duties, identify commodity categories with high savings potential, assist the department in pursuing savings from selected categories, and develop and implement methodologies for calculating associated savings.

RESULTS IN BRIEF

We did not find significant opportunities for additional savings from greater utilization of Smart Buy contracts or increased efforts in pursuing recommended commodity categories. However, we found the state could attain additional savings by earning available rebates from one Smart Buy vendor, OfficeMax. Specifically, the state earned less than 30 percent of the fiscal year 2006 rebates available for either paying invoices within 10 days or making payments by electronic funds transfer (EFT). Personnel at several agencies mentioned they were unaware of the available rebates. Moreover, the department did not have

procedures in place to monitor whether agencies were earning available rebates. Lastly, the department had not yet updated the state's accounting system with the appropriate vendor account information to allow agencies to issue the vendor EFTs. The state could have earned an additional \$111,000 by earning at least 75 percent of the available prompt payment and EFT rebates.

RECOMMENDATIONS

We recommend the department:

- Develop procedures for periodically informing agency staff of the conditions agencies must meet to receive OfficeMax rebates and the benefits of doing so.
- Consider periodically monitoring agencies' success at earning available rebates.
- Obtain the necessary vendor account information and update the state accounting system to allow agencies to issue OfficeMax payments by EFTs.

OTHER MATTERS

During the course of our audit, we identified several instances in fiscal year 2006 in which OfficeMax overcharged for items classified as non-essential. We found the department did not take the measures necessary to provide reasonable assurance that prices OfficeMax charged for these items were consistent with the contract terms. See page 3 for the associated recommendations.

AGENCY'S RESPONSE

The Department of Administrative Services generally agrees with the recommendations. The department's complete response begins on page 3.

MANAGEMENT LETTER

During our review, we identified a risk concerning the accuracy of factors the department used in its methodology for calculating the Smart Buy program's savings. We conveyed the matter to the department in Management Letter 107-2007-08-01 dated August 22, 2007.

Background

The Governor's office introduced the Smart Buy program in 2003 and assigned the Department of Administrative Services (department), the state's central procurement authority, to administer the program. The department's director appointed a steering committee, which included representatives from various agencies, to provide overall project guidance and recommend specific courses of action.

At the onset of the Smart Buy program, the department contracted with the consulting firm Silver Oak Partners, Inc. (Silver Oak), which specialized in strategic procurement, to identify commodity categories with high savings potential. The department later contracted with Silver Oak to, among other duties, help pursue savings from the identified categories, and implement methodologies for calculating savings achieved.

Subsequently, the department implemented various procurement strategies to improve the state's purchasing power. These included renegotiating current contracts or soliciting new contracts to obtain lower prices and aligning agency purchases to their business needs to eliminate unnecessary spending.

Audit Results

Our audit objective was to determine whether there were opportunities for additional savings under the Smart Buy program through improved management practices. To accomplish that objective, we reviewed the extent to which the department had implemented at least one procurement strategy for each commodity category Silver Oak identified as having high savings potential, whether greater utilization of Smart Buy contracts during fiscal year 2006 would have

led to significant additional savings, and agencies' success at earning office supply rebates under the program.

We did not find significant opportunities for additional savings from greater utilization of Smart Buy contracts or increased efforts in pursuing recommended commodity categories. However, we did find the state could attain additional savings by earning available rebates from OfficeMax, one Smart Buy vendor.

Department Took Reasonable Actions to Pursue Savings

The department contracted with Silver Oak for assistance in obtaining savings for 11 commodity categories including office supplies, desktop and laptop computers, office equipment, and wireless communication. Silver Oak also suggested several procurement strategies the department could employ to attain the savings. These included issuing competitive solicitations, renegotiating with current vendors to obtain more favorable pricing, and implementing demand management policies to match agencies' projected consumption to appropriate usage plans.

We reviewed the department's actions to pursue savings for the 11 contracted commodity categories. For each of the 11 categories, the department implemented at least one of Silver Oak's suggested procurement strategies. For four of the 11 commodity categories, the department issued competitive solicitations. For example, the department issued a request for proposals for the personal computer (PC) hardware category. It then awarded contracts to multiple vendors for standard desktop and notebook configurations.

The department renegotiated contract terms for another four

commodity categories. For example, it renegotiated prices for the state's most frequently purchased office supplies and discounts for office supplies not considered "essential." The department's renegotiation also resulted in rebates agencies could earn for meeting certain purchasing and payment conditions.

Lastly, for three categories, the department implemented demand management strategies. For instance, it implemented a "right-sizing" strategy for copiers that matched agencies' anticipated workloads to the copiers of the appropriate size and capacity.

We also reviewed the department's actions to pursue savings from six other commodity categories Silver Oak recommended as having high savings potential that were not included in the Silver Oak contract. Although the department had not yet pursued new contracts for four of the six categories, it had reasons for not doing so. These reasons related to the number of agencies that might benefit from a new contract, the desire of affected agencies to have a Smart Buy contract in place for the commodities in question, and the competitiveness of the existing contract.

Agencies Utilized Smart Buy Contracts

To determine whether agencies were using Smart Buy contracts, we randomly sampled 67 purchase transactions for office supplies, PC hardware, and PC peripherals made from non-Smart Buy vendors during fiscal year 2006. The selected transactions totaled approximately \$593,000 or 19 percent of the dollars in our population. Only 2 percent of the \$593,000 in transactions we reviewed were for items available under applicable Smart Buy contracts. We therefore concluded,

for the period and the commodity categories we reviewed, agencies were mainly using Smart Buy vendors for items available under those contracts. We also concluded expending additional resources to achieve greater utilization of these Smart Buy contracts would not result in significant additional savings.

Additional Rebate Dollars Were Available

Agencies did not consistently earn available office supply rebates during fiscal year 2006.

In June 2004, the department amended the contract with OfficeMax to allow agencies to receive rebates for meeting certain purchasing and payment conditions.¹ Under the amended contract terms, agencies could earn the following rebates from their purchase total:

- 1.5 percent for placing orders online;
- 1.5 percent for purchases totaling \$200 or more (and lesser percentages for values less than \$200);
- 1 percent for paying invoices within 10 days of the invoice date (and lesser percentages for periods up to 20 days); and
- 1.5 percent for utilizing electronic funds transfers (EFTs) to submit payment electronically.

OfficeMax applied these rebates as a credit towards future purchases.

We reviewed OfficeMax's rebate and monthly usage reports to determine the amount of rebate dollars available to and earned by agencies in fiscal year 2006. For two of the four types of rebates,

¹OfficeMax was formerly known as Boise Cascade. Boise Cascade changed its name in 2004 after acquiring OfficeMax. The contract with OfficeMax is scheduled to expire in March 2009.

agencies earned the majority of rebates available. Specifically, the agencies earned approximately \$219,000, or nearly 75 percent of the rebate dollars available for ordering online and meeting minimum purchase totals.² However, agencies earned less than 30 percent of the fiscal year 2006 rebates available for paying invoices within 10 days and for making payments by EFT.³ Agencies could have earned an additional \$111,000 had they earned prompt payment and EFT rebates at a rate comparable to those earned for ordering electronically and meeting minimum purchase totals.

We interviewed staff from several agencies that, during our test period, earned little to no prompt payment and EFT rebates. Agency staff responsible for ordering and paying for office supplies were not aware of the rebates offered under the OfficeMax contract. Staff suggested their agencies would have pursued rebates more vigorously had they been aware of the potential savings.

In addition, the department did not adequately monitor monthly rebate reports OfficeMax provided to ensure agencies were earning available rebates. Moreover, the department did not update the state's accounting system with the vendor's account information necessary for agencies to issue EFT

²We identified multiple instances during our test period in which OfficeMax applied incorrect rebate rates for purchases totaling between \$150 and \$175. The error accounted for approximately \$1,800 in additional rebates owed the state. We provided this information to the department so that it can pursue credit for the rebates owed.

³In following up on potential EFT rebate anomalies, we learned from OfficeMax that it incorrectly credited some EFT rebates during our audit period. As a result, the amount of actual rebates earned for EFT payments is less than that shown on the vendor's reports. We did not attempt to verify the actual amount of EFT rebates earned.

payments. Consequently, the state's accounting system was not capable of issuing EFT payments to OfficeMax.

We recommend the department:

- Develop procedures for periodically informing agency staff of the conditions agencies must meet to receive OfficeMax rebates and the benefits of doing so.
- Consider periodically monitoring agencies' success at earning available rebates.
- Obtain the necessary vendor account information and update the state accounting system to allow agencies to issue OfficeMax payments by EFTs.

Agency Response:

Thank you for providing us the draft report on the Oregon Smart Buy program dated April 24, 2008. We appreciate the time and effort your team has spent reviewing this program over the last 16 months. The Department generally agrees with the findings as stated in the report and offers the following in response to your recommendations.

Rebate Realization. *The draft report makes three recommendations to improve the state's ability to earn the maximum rebates available in the office supplies contract. The State Procurement Office (Office) has already started to work on some of these recommendations.*

Recommendation 1: Develop procedures for periodically informing agency staff of the conditions agencies must meet to receive OfficeMax rebates and the benefits of doing so.

The Department agrees with this recommendation. The State Procurement Office recently updated the price agreement summary on the automated procurement system (ORPIN) to advertise the different rebates available to agencies on the

OfficeMax contract. The Office will also provide updates in its Spring/Summer newsletter and through its e-mail list-serve known as "Buyer Link".

However, your report mentions that agency staff responsible for ordering and paying for office supplies were not aware of the rebates offered. The State Procurement Office believes that many of these types of agency staff do not routinely view the statewide price agreement information on ORPIN, nor do they necessarily see its newsletters and e-mails. To offset this problem, the Office will also look for other ways to periodically inform agency staff about the benefit of the rebates and the conditions of use. For example, one connection could be through the State Controller's Division's "Accounts Payable Forum," which meets quarterly.

Recommendation 2: Consider periodically monitoring agencies' success at earning available rebates.

The Department agrees that the State Procurement Office should provide guidance and help to agencies to position them to be successful in earning available rebates on statewide contracts.

The State Procurement Office has limited resources to perform detailed monitoring and follow up on agency accounts payable activities, such as timely bill payment or electronic funds transfers to achieve quick-pay discounts. Also, the Department has some questions about how extensive its monitoring responsibilities should be under the general procurement authority of the Department.

State Procurement Office staff will review the vendor-provided rebate reports with OfficeMax and the State Controller's Division to determine what reasonable methods or procedures are

available to accomplish maximum rebate realization for the duration of this contract. One possibility may be to have the vendor supply rebate reports directly to agency staff responsible for payment of office supply bills along with the training and instruction needed to self-monitor the rebate achievement rate.

Recommendation 3: Obtain the necessary vendor account information and update the state accounting system to allow agencies to issue OfficeMax payments by EFT's.

The Department agrees and the State Procurement Office will follow up with the State Controller's Division on the steps necessary to enable EFT transactions for the remainder of the current price agreement.

The State Procurement Office is preparing to re-solicit the contract for office supplies this summer. Based on these audit findings, the Office will carefully consider how rebates are used as a part of the ultimate "best value" in this contracting effort. The Office will pay particular attention to the ability of state agencies to efficiently and effectively realize full rebate potential. The Office may use other means to achieve a best-value business proposition for the state with the next contract.

Other Matters

During our review period, the department amended the pricing structure of the office supply contract with OfficeMax. The department negotiated specific prices for items classified as "essential," while contract items not classified as "essential" were discounted off the list price.⁴ The

⁴The list price is defined as the contractor's price for a product as listed in the contractor's catalog and its website. For our audit purposes, we relied on the 2005 and 2006 catalogs to

amended contract also allowed OfficeMax, with the department's approval, to raise list prices for non-essential items to reflect increases in supplier costs.

We reviewed the prices OfficeMax charged agencies for 26 non-essential items during fiscal year 2006 and found that OfficeMax overcharged agencies for 12 of the 26 items, with the overcharges averaging 4 percent above the contract prices.⁵

In a separate analysis, we compared contract prices for 28 items to those in applicable Net Pricers (lists the vendor distributed to agencies as a record of contract prices). For 16 of the 28 items, prices on the Net Pricers were an average 17 percent higher than the contract prices.⁶ Accordingly, neither the Net Pricers nor the prices OfficeMax charged agencies were always consistent with the pricing terms established under the amended contract.

Several factors contributed to the pricing exceptions. First, although required under the contract, the department did not explicitly approve price changes OfficeMax made to non-essential items. In addition, the department did not review Net Pricers prior to their distribution to agencies to ensure the prices OfficeMax charged for non-essential items were appropriate. Furthermore, the department did not retain documentation of approved price changes and revised Net Pricers, which would allow for comparison after the effective date of a price

determine the list prices applicable to our test period.

⁵We identified several instances in which OfficeMax charged agencies lower prices than the contract prices. However, lower prices for these items did not indicate a violation of contract terms.

⁶We identified instances in which the Net Pricer contained prices that were lower than the contract prices. Lower prices did not indicate a violation of contract terms.

change. Lastly, the department did not periodically review OfficeMax purchases to verify that agencies were not paying more than the approved prices.

We recommend the department:

- Explore the extent of overpayments resulting from overcharges OfficeMax made during and after our test period and seek repayment or credit from the vendor.
- Implement procedures to provide reasonable assurance that agencies are not paying higher prices for non-essential items than specified under the contract.

Agency Response:

Other Matters. *The draft report makes two recommendations related to pricing of non-essential items available from the OfficeMax catalog.*

Recommendation 1: *Explore the extent of overpayments resulting from overcharges OfficeMax made during and after our test period and seek repayment or credit from the vendor.*

The Department agrees and the State Procurement Office is working with OfficeMax to determine the extent of overcharges OfficeMax made during and after the test period and will make every effort to recover any amounts owed to the state. The audit team has been very helpful in transmitting detailed information to the State Procurement Office and OfficeMax to get this process started. As noted in your findings, OfficeMax also granted more rebates to agencies than were required in the contract, so the final amount of potential recovery is unknown at this time.

Recommendation 2: *Implement procedures to provide reasonable assurance agencies are not paying higher prices for non-essential items than specified under the contract.*

State Procurement Office staff shared with the audit team that they are not able to fully confirm your findings. The reason for this is the current contract for office supplies is complex, difficult and time-consuming to monitor. Statewide, transactions number between 35,000 and 45,000 per month. The number of non-essential products available is over 40,000 catalog items. Non-essential products are priced using a discount from list price rather than a specific price for each item as negotiated for all the items classed as "essential". In addition, there are four different types of rebates to further complicate price verification. In spite of the difficulties in monitoring the non-essential item prices, the Department agrees with your recommendation that the Office must assure that agencies do not pay higher prices than allowed by the contract.

As to specific action steps, the State Procurement Office is now keeping copies of all OfficeMax's pricing documentation. Also, the Office is requiring OfficeMax to submit price changes to non-essential items for explicit approval. Subsequent to any approved price changes, the State Procurement Analyst in charge of administering this contract will review net pricing information prior to distribution to agencies to ensure prices charged are appropriate. Within the limits of its resources, the State Procurement Office will periodically sample agency purchases to verify agencies are not paying more than the approved prices for non-essential items.

Finally, it should be noted that the State Procurement Office needs to complete the work necessary to re-solicit for office supplies. The State Procurement Office has scheduled re-solicitation for this summer and will strive to have a new contract in place before the end of 2008. The Office will apply

lessons learned through the audit engagement in the solicitation and administration of the new statewide price agreement for office supplies.

The Department appreciates the audit team's help over the past 16 months in analyzing and discussing contract performance issues related to the Smart Buy program, especially around office supplies. The State Procurement Office staff believes they are prepared to achieve better business results and additional savings in the future based on this experience.

Audit Objectives, Scope and Methodology

Our audit objective was to determine whether there were opportunities for additional savings under the Smart Buy program through improved management practices. To accomplish our objective, we reviewed the extent to which the department implemented at least one procurement strategy for each commodity category Silver Oak identified as having high savings potential, whether greater utilization of Smart Buy contracts during fiscal year 2006 would have led to significant additional savings, and agencies' success at earning rebates under the program.

To identify procurement strategies the department implemented, we interviewed department personnel, reviewed contract deliverables Silver Oak produced, and reviewed other relevant documentation.

To determine whether agencies utilized Smart Buy contracts during our test period, we reviewed fiscal year 2006 purchases we classified as office supplies, PC hardware, or PC peripherals to identify purchases agencies made from vendors not under a Smart Buy contract. We then randomly selected 67 transactions and

reviewed associated invoices and other relevant documentation to determine whether the purchases consisted of items available under the Smart Buy contracts. To identify the transaction population, we relied on purchasing data extracted from two of the state's financial management systems and the state's procurement card system maintained by a third party. Therefore, our testing was limited to purchases agencies made through one of the three systems. We performed data reliability testing by tracing purchase amounts and vendor names for the 67 sampled purchases to amounts and names contained on invoices and other purchase documentation. We found the three systems' purchase data to be sufficiently reliable for our audit purposes.

To determine whether agencies earned available rebates, we reviewed OfficeMax rebate and purchase data for fiscal year 2006. We also relied on the vendor's monthly usage reports to determine the amount of rebates available to agencies. We calculated that amount by multiplying agencies' total dollars spent, as reported in the monthly usage reports, by the applicable rebate percentages for meeting the following conditions:

- placing orders online;
- submitting orders equal to or greater than \$200;
- making payments to the vendor within 10 days of the invoice date; and
- issuing payments using EFTs.

To determine whether OfficeMax charged prices consistent with contract terms, we calculated contract prices for 26 items agencies purchased in fiscal year 2006 by multiplying list prices by the applicable discount rate. We relied on OfficeMax's 2005 and 2006 catalogs to determine list prices. We then compared our

calculated discount prices to prices OfficeMax charged agencies during our test period. We also compared our calculated discount prices for 28 items to prices in fiscal year 2006 Net Pricers.

Auditing standards require auditors to be organizationally independent of the audited organization to avoid the possibility or perception of a relationship that could impair the audit work done or the findings reported. This audit was performed by staff members of the Oregon Audits Division, a branch of the office of Secretary of State. Accordingly, we excluded from our test results purchases the Secretary of State made during our test period, as well as any rebates available to or earned by the Secretary during the same period.

The current Deputy Secretary of State served as a member of the steering committee that provided oversight for the Smart Buy program. However, because the deputy did not play a role in determining the scope of our audit or the information we present in this report, we do not believe the deputy's participation on the steering committee constitutes an organizational impairment.

During our review, we identified a risk concerning the accuracy of the factors used in the department's methodology for calculating the Smart Buy program's savings. We conveyed the matter in Management Letter 107-2007-08-01 dated August 22, 2007.

We conducted this audit in accordance with generally accepted government auditing standards.



**Secretary of State
Audits Division**

**255 Capitol St. NE, Suite 500
Salem, OR 97310**

**Auditing to Protect the
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AUDIT MANAGER: *James E. Scott, MM*

AUDIT STAFF: *Andrew M. Love
Weston R. Brinkley
Brianna R. Proctor*

DEPUTY STATE AUDITOR: *William K. Garber, CGFM, MPA*

The courtesies and cooperation extended by the officials and staff of the Department of Administrative Services were commendable and much appreciated.

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or by mail from:

*Oregon Audits Division
255 Capitol Street NE, Suite 500
Salem, OR 97310*