



A REPORT
TO THE
MONTANA
LEGISLATURE

PERFORMANCE AUDIT

Improving Montana's Office Supply Acquisition Processes

Department of Administration

OCTOBER 2011

LEGISLATIVE AUDIT
DIVISION

11P-09

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PERFORMANCE AUDITS

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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October 2011

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit on Improving Montana's Office Supply Acquisition Processes. This report presents audit findings and includes recommendations that will provide cost savings on the routine purchase of office supplies and strengthen the monitoring of office supply contractor performance. A written response from the Department of Administration is included at the end of the report.

We wish to express our appreciation to Department of Administration officials and staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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MONTANA LEGISLATIVE AUDIT DIVISION

PERFORMANCE AUDIT

Improving Montana's Office Supply Acquisition Processes

Department of Administration

OCTOBER 2011

11P-09

REPORT SUMMARY

Existing processes for purchasing office supplies could be improved to reduce costs to agencies. We identified \$109,000-\$139,000 in potential savings during a review of a six-month time period.

Context

Office supplies are necessary for the day-to-day function of any business or government agency. In Montana, state agencies purchase essential supplies such as paper, pens, toner, and tape through a statewide contract with a private contractor, through the state operated Central Stores warehouse, or from the retailer of their choice. Products from the contractor and Central Stores may be ordered through a single website while purchases made through other retailers may be in local stores or online. We reviewed transactions for each of these types of purchases with two objectives:

1. To determine if the processes in place for office supply acquisition obtain products at the lowest available price.
2. To evaluate management of the office supply acquisition processes.

We obtained transaction level data for office supplies for a six-month time period and compared the prices paid to the prices for which identical or equivalent products could be obtained from other sources during the same time period. We also obtained information related to office supply procurement in other states, evaluated monitoring procedures for each procurement method, and conducted a survey of individuals who purchased office supplies.

Results

The existing statewide contract calls for the contractor to deliver office supplies to the Central Stores warehouse in Helena. State personnel at this warehouse then deliver (or arrange for delivery) to the ordering agency. A markup is added to the cost of contractor supplied items to cover overhead and delivery. There were a total of \$1.28 million in sales under the contract for the six-month timeframe we considered. We identified potential savings of \$103,000 if the Department of Administration would adopt a contract that provides vendor-direct delivery of contract items. The contract used for this pricing analysis features an optional administrative fee. If the maximum fee was added to the cost of products under this contract the potential savings would be reduced to \$83,000.

Central Stores carries three basic lines of products: office supplies, food service disposables, and custodial products. Products are ordered from various vendors and warehoused in Helena, where they may be ordered by agency end users. There are a total of 100 different types of office supplies in its catalog, mostly commonly purchased items such as paper, batteries, or mailing labels. Central Stores buys products from vendors using a competitive process then adds a markup to each product that it sells

(continued on back)

to cover the overhead and delivery costs. The total dollar value for Central Stores office supply transactions during the time period analyzed was \$485,000. We identified potential savings of \$31,000-36,000 if the Department of Administration would adopt a contract that provides vendor-direct delivery of warehoused items. These contracts also feature an optional administrative fee. If the maximum fee was added to the cost of products under these contracts the potential savings would be reduced to \$26,000-28,000. Together with the potential savings discussed in the previous paragraph, these savings yield a total of \$109,000-139,000 in potential savings during the six months we reviewed.

If the Department of Administration does award a contract as described above it should also implement a process to monitor the performance of that contractor. Such a process would help ensure the contractor fulfills the contract as intended. Without periodic monitoring a contractor could bill at rates that are higher than those which are required by contract or the contractor may perform poorly in terms of service or delivery time.

Finally, there are many transactions with office supply retailers outside the existing state programs. The total value of transactions with office supply retailers using a state issued procurement card during our time period was \$781,000. These purchases are allowable if the product purchased is less expensive than through the state sponsored programs. We reviewed a sample of products from this set of transactions and found that in 24 of 29 cases the purchased products cost more than they would have through the state website. The Department of Administration should increase its outreach to state agencies to promote the requirements and benefits of using the state sponsored programs for purchasing office supplies.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	0
Source: Agency audit response included in final report.	

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Chapter I – Introduction

Introduction

Goods and services procured from private vendors are vital to the operations of state government. Virtually all agencies require basic office supplies such as paper, toner, writing utensils, and other common office products in order to complete daily tasks. Montana state agencies obtain office supplies from three primary sources: a statewide contract for online ordering of office supplies, the Central Stores program within Department of Administration (DOA), or through other private vendors.

This audit focused on the prices paid for products via each method in comparison to alternative methods of purchase. It also reviewed other related topics, including whether DOA has evaluated each method and potential alternatives, if agency staff are aware of all potential procurement methods and are able to purchase from the vendor that is most advantageous.

Methods of Office Supply Procurement

In Montana, state agencies purchase office supplies through a statewide contract with a private contractor, through the state operated Central Stores warehouse, or from a retailer of their choice. Products from the contractor and Central Stores may be ordered through a single website known as Eway while purchases made through other retailers may be in local stores or online.

Statewide Contract

In February 2006, the Department of Administration awarded a contract to a private contractor to provide statewide online ordering of office supplies through a central website. The intent of this contract is to provide state agencies with an expedited means of procuring office supplies at competitive prices. The contract was awarded by the State Procurement Bureau and is administered by the Central Stores program. This contract is considered to be an “exclusive” use contract and state agencies should obtain the specified product from the contract holder with certain exceptions, including:

- ◆ If a supplier provides an office supply at less than the price offered through the contract, and
- ◆ The Montana University System has optional use of the contract.

The contractor offers a line of office supplies through an online and paper catalog. Supplies provided by the contractor are generally offered at a discount from a “list” price. Products ordered through the website are shipped to the state’s Central Stores warehouse and subsequently delivered to the requesting agency by Central Stores staff

or a contracted delivery service. Central Stores (discussed below) attempts to combine shipments to agencies to include both products ordered through the online contractor and its own products.

Central Stores

Part of DOA's General Services Division, Central Stores was initiated in 1980 to serve as a single source supplier for agency supply essentials. It initially stocked all the office products thought to be of need to state agencies. But, as agency requirements diversified, it became more difficult for Central Stores to carry the full range of desired items. Today, Central Stores offers three types of commonly used products: office supplies, custodial supplies, and food service disposables. Within the office supply genre are products such as white and colored paper, batteries, and mailing labels. These products are stored at a Helena warehouse and delivered to state agencies throughout Montana.

Products available through Central Stores are priced based on a markup percentage over the item's acquisition cost. The markup is meant to cover operations costs for Central Stores including costs associated with shipping, billing, and customer service. A markup is also applied by Central Stores to the contractor supplied products that are delivered under the terms of the statewide contract discussed above. Agencies may place orders directly through Central Stores or use the website administered by the private contractor.

In 2004, DOA commissioned a consultant to study the cost-effectiveness of Central Stores operations. The consultant concluded that outsourcing the Central Stores function to the private sector was financially equivalent to maintaining a state-operated warehouse. Based on the lack of demonstrable savings from continuing the state operation, DOA staff members indicated that a transition to a private function was planned. Momentum for this plan was lost, however, when the 2005 legislature heard a bill prohibiting the privatization of Central Stores. The bill did not pass but the plan to outsource Central Stores also failed to advance.

Other Retailers

If a product is available through a vendor other than Central Stores or the online contractor at a lower price a state agency may also purchase the product from the lower priced vendor. State law requires contracts for office supplies must stipulate that products which conform in all material respects to those offered by the online contract or Central Stores program may be purchased elsewhere if available at less cost.

Objectives, Scope and Methodologies

This audit focused on whether these supplies are obtained by means which maximize the state's purchasing power and if the acquisition processes are effectively managed. We developed two audit objectives:

1. Determine if the processes in place for office supply acquisition obtain products at the lowest available price.
2. Evaluate management of the office supply acquisition processes.

To determine if purchases within each acquisition method are made so that purchasing power is maximized, we evaluated product pricing for office supply transactions that occurred within a time period covering six months. Purchases were made by any state agency, including the university system. A six-month period was used to ensure seasonal items were included and to provide a large enough volume of transactions for reliable information on which to base conclusions. The time period reviewed was July 1, 2010, through December 31, 2010. We compared the prices for products that were deemed to be identical based upon matching manufacturer stock-keeping unit numbers or other unique product codes. When we could not identify identical products, equivalent products were sometimes compared. Auditors matched specifications to ensure products were equivalent.

Pricing data for the existing statewide contract, Central Stores, and procurement card transactions came from actual transactions during the reviewed time period. We compared the data for a sample of transactions for each process to agency records in order to provide reasonable assurance that the data used was accurate. We also used pricing data from regional multi-state contracts which Montana is eligible to use. Montana does not currently participate in these contracts so we could not verify the pricing data against state records but we did obtain and compare the prices supplied to transaction data from another state and the price data appeared to be accurate.

In addition to prices paid during acquisition, we evaluated management of the acquisition processes by the Department of Administration. To do this we obtained information related to office supply procurement in other states. We also evaluated monitoring procedures for the various acquisition processes. To assess the efficiency of using Central Stores as a central delivery point, we analyzed the composition of orders fulfilled by Central Stores and analyzed the dollar volume of office supplies ordered by geographic area of delivery. We interviewed agency staff members and employees of private office supply vendors. Finally, we conducted a survey of state agency personnel who purchased office supplies via each of the three acquisition methods described above.

Areas for Further Study

During this audit we identified two areas which we believe warrant consideration for future performance audit work:

Agency Management of Procurement Card Purchases

One of the methods by which office supplies are purchased is using a state issued procurement card. The procurement card program is administered by the Department of Administration but each department is responsible for the review of individual transactions made with the cards. Management authority for most procurement card transactions is delegated to the using agency. A future performance audit could evaluate how agencies monitor procurement card activity including approval of employees to receive cards, training cardholders on proper use of cards, and reviewing transactions.

Pricing Analysis of Other Products Sold by Central Stores

This audit focused on the purchase of one particular class of goods—office supplies. The Central Stores program also procures and resells two other product types, custodial supplies and food service products. A performance audit could evaluate the prices available for those other classes of products to determine whether agencies can obtain products at the lowest available price and evaluate management of the acquisition processes.

Report Organization

The remainder of this report details our analysis of the audit objectives and contains three recommendations. It is organized in two additional chapters:

- ◆ Chapter II - Pricing Analysis for Acquisition Methods
- ◆ Chapter III - Management of Procurement Methods

Chapter II – Pricing Analysis for Acquisition Methods

Introduction

This chapter addresses our first objective, to determine if the processes for office supply acquisition obtain products at the lowest available price. In order to facilitate the purchase of office supplies by state agencies, the Department of Administration (DOA) operates a Central Stores program to warehouse commonly purchased items. It also has a contract to provide a wide array of other office products (but may also sell products equivalent to those sold directly by Central Stores). Under the terms of the contract, the contractor provides a website through which agency users can place orders for both contractor supplied and Central Stores products. The website provides agency users with a single order point for goods from both sources. Additionally, products supplied by the vendor are shipped to the Central Stores warehouse in Helena and are subsequently delivered by Central Stores or a contracted delivery company to the end-user. This provides agency users with a single delivery for their orders. We concluded improvements could be made to these processes which will provide cost savings to agency users. The remainder of this chapter details our findings.

Statewide Contract for Online Ordering

In February 2006, the Department of Administration executed the current contract to supply office products to state agencies. The contract has been renewed annually since that time. The current contract expires in February 2012 and is eligible to be renewed one additional year. Prices for products for the time period used for our audit were determined on a “discount from list” basis. This means the contractor supplied products at a predetermined discount from a catalog price. The price paid by the end-user of each product includes a markup added by Central Stores that is designed to cover the overhead and delivery costs associated with providing the supplies. The maximum markup rate is set by the legislature as part of House Bill 2 and was set at 25percent of the retail cost of goods sold during fiscal years 2010-11. The actual markup rate for contractor supplied products is 20 percent.

The contract also requires that contractor supplied items be delivered to the Helena warehouse “within one to two working days from the Contractor’s receipt of order.” Once products are received by Central Stores the goal is to deliver or ship orders within 24 hours, though some outlying locations may not receive deliveries for two days.

Central Stores

Central Stores carries three basic lines of products: office supplies, food service disposables, and custodial products. This report focuses only on the office supply portion of the Central Stores catalog. Products are ordered from various vendors and warehoused in Helena, where they may be ordered by agency end users. Some of the types of products that were once supplied directly by Central Stores are now provided by the private contractor. Central Stores does continue to list a total of 100 different types of office supplies in its catalog.

Central Stores obtains the products it stocks via a competitive process. Some products, such as paper, are ordered on a quarterly basis. Other products are ordered when warehouse stocks become depleted. Central Stores pays vendors for these products and adds a markup to each product that it sells to end users. Like products ordered through the statewide contract, the current maximum markup rate is 25 percent though most products stocked by Central Stores are actually marked-up between 15-20 percent.

Table 1
Office Supply Sales Volume
July 1, 2010 - December 31, 2010

Program	Sale
Statewide Contract	\$1,277,255
Central Stores	\$485,304

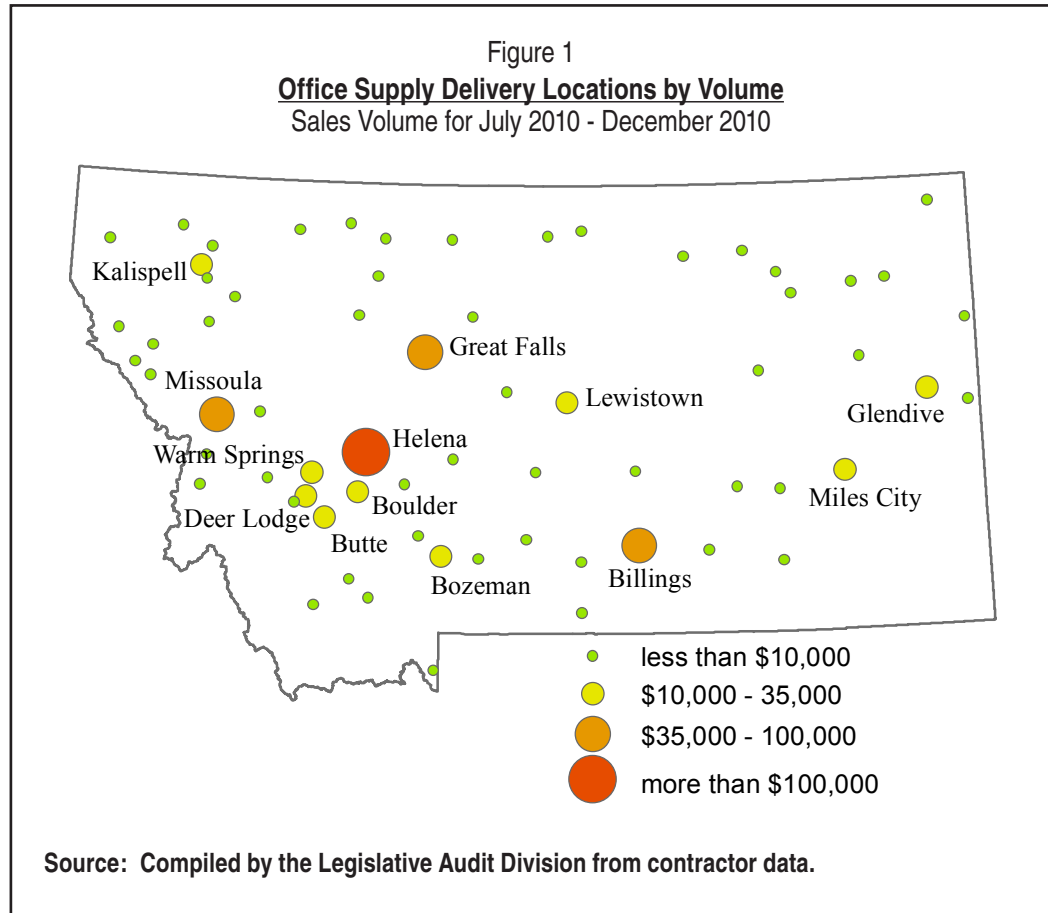
Source: Compiled by the Legislative Audit Division from Department of Administration and contractor data.

Table 1 displays the sales volume in dollars for each of these acquisition methods during the six-month time period we analyzed.

Where are Office Supplies Delivered?

To evaluate the efficiency of using Central Stores as a central delivery point, we analyzed the delivery location

for products that were ordered through the statewide contract. To determine where the orders are delivered, we obtained a summary of orders for contractor provided products that were placed on the website by state agency end users. Figure 1 displays a map of the state showing the cities and towns to which office supplies were delivered during the six months we analyzed. Locations with higher sales volumes are depicted with larger circles.



Approximately 55 percent of the sales were within Helena. Orders were placed by agency employees in 66 cities and towns throughout Montana. Of these, 13 locations had orders in excess of \$10,000 during the time period. The orders are delivered by Central Stores personnel within Helena, but contracted delivery services are used to deliver supplies to offices in outlying areas.

CONCLUSION

Most orders are delivered within Helena, but there are 66 other locations to which office supplies are delivered.

Most States Use Direct Delivery Model

Many states and other governmental entities contract for their office supplies with a private contractor or contractors. Identical or equivalent office products to those warehoused by Central Stores and sold through the current contract are generally available directly through private vendors. Several cooperative programs have emerged for this purpose as well. One such example is the Western States Contracting Alliance

(WSCA). Montana is a member of this purchasing group. In 2010, this group awarded a contract with three separate contractors that states may use to purchase office supplies. This contract calls for the price to include the cost of delivery from the contractor to the end-user and for next business day delivery. Products ordered under such a contract would not be subject to a separate markup for delivery or overhead. There is an optional administrative fee of one or two percent that a state can choose to add to the price of products to cover contract administration. If Montana were to join this contract it is possible that deliveries to some remote areas would take more than one business day.

During this audit, we interviewed procurement professionals from four other states. Three of these states contracted with a private vendor to provide office supplies to agency users. Each of these states utilized a direct to end-user delivery model. In 1997, the state of Utah surveyed nine western states and at that time, only two states did not use a vendor-direct delivery model, Washington and Montana. Since that time, Washington has also moved to direct delivery.

Cooperative Program Used as Benchmark

In this report, we reference contracts obtained through WSCA. We used these contracts as benchmarks because Montana is eligible to use them, the prices were available, they include a wide range of products, and prices include delivery to the end-user. The prices are estimates of what an end-user could expect to pay for office supplies under an alternative delivery system. Our audit work indicates direct delivery of office supplies could decrease the state's overall costs for these products. We did not conclude that the WSCA pricing was preferable to other alternatives such as a state specific contract or another cooperative purchasing program.

What is the Composition of Online Orders?

One of the stated benefits of the state's online ordering system is that it is a single ordering point for items stocked by Central Stores and supplied by the contractor. When an order is placed by a user, any contractor supplied products are shipped to the Central Stores warehouse where they are combined with products that are also ordered but stocked by Central Stores. For orders outside of Helena, small boxes are sent via parcel delivery while larger orders are shipped via a contract trucking firm. It is the goal to get the products to each agency the next day, though for some of the outlying offices two days are needed.

We studied what proportion of orders are composed of only items supplied by the contractor, which are only Central Stores items, and how many are combined. The markup added to these products could potentially make them more expensive than products available through other means and may also add shipping time. We reviewed a sample of invoices and recorded their composition. The results are displayed in Table 2.

Table 2
Percentage of Online Orders By Product Source

	Central Stores Only	Combination	Contractor Only	Total
Total Invoices	1,123	2,097	8,303	11,523
% of Total	9.7%	18.2%	72.1%	100.0%

Source: Compiled by the Legislative Audit Division from Department of Administration records.

As shown in the table, nearly three-quarters of office supply invoices contain only contractor supplied items. These products are shipped to central stores and subsequently reshipped to the end-user.

CONCLUSION

The majority of orders placed by end users contain only products supplied by the contractor. The current system requires these products to be shipped to Central Stores and then re-shipped to the end-user.

Montana's Model Requires Product Markups for Overhead and Delivery

Once products arrive at the Central Stores warehouse in Helena, additional costs must be incurred in order to deliver the supplies to the ordering agency. The markup that is added to both contractor supplies and Central Stores own products is meant to cover the costs associated with overhead and delivery of the supplies.

Markup Makes Products More Expensive

The markup needed to cover the costs of overhead and delivery adds to the price originally paid for each product. We compared prices for the products ordered during the six-month time period under the existing state contract to prices available from the same vendor under a different contract. The contract we used was awarded by the Western States Contracting Alliance and it is designed to deliver office supplies directly to the end-user. We used this contract because it provided a realistic estimate of pricing under a direct delivery scenario. We were able to match 6,924 of the 7,969 (86.9 percent) different products that were purchased during the time period using identical product codes. These products were purchased for a total of \$1,126,586 or 88.2 percent of the total dollar volume spent during the period. We calculated the total amount that would have been spent if the state instead chose to have items delivered directly to

the end-user via the WSCA contract. Had these same products been ordered via the WSCA contract the state could have experienced a savings of \$103,134. The potential savings are illustrated in Table 3. The WSCA contract features an optional administrative fee of one or two percent. The potential savings above does not include

this fee. If a two percent fee was added to the direct delivery cost, the potential savings would be reduced by about \$20,000.

Table 3
Potential Savings for Office Supplies With Direct Delivery

Current Contract Cost	Direct Delivery Cost	Potential Savings
\$1,126,586	\$1,023,452	\$103,134*

*The potential savings listed above does not include an optional administrative fee. If the maximum administrative fee were included the potential savings would be reduced by approximately \$20,000.

Source: Compiled by the Legislative Audit Division from contractor data.

The time period we reviewed for this analysis was July 1, 2010 - December 31, 2010. Since that time, the Department of Administration and the contractor have renewed the contract and amended the pricing structure. We also asked the contractor to perform a similar analysis for a more recent time period (April 1, 2011 - July 1, 2011). The contractor analysis also indicates that a direct delivery model would yield cost savings. During the three month period used, the state spent a total of \$768,387 on office

supplies. Under the WSCA contract the state could have saved \$75,484. These results are summarized in Table 4.

Table 4
Potential Savings With Direct Delivery Under Most Recent Pricing

Current Contract	Direct Delivery Cost	Potential Savings
\$768,387	\$692,903	\$75,484*

*The potential savings listed above does not include an optional administrative fee. If the maximum administrative fee were included the potential savings would be reduced by approximately \$14,000.

Source: Compiled by the Legislative Audit Division from contractor analysis.

In addition to the cost savings, delivery time may also be improved under a direct delivery scenario. The state's current contract allows

two days for delivery to Central Stores. Once products are received by Central Stores it can take an additional two days to reach the end-user. The WSCA contract requires next business day delivery. If Montana were to join this contract some remote locations may require more than one business day for delivery.

Central Stores Prices More Expensive Than Direct Delivery Options

In a separate analysis, we also compared the prices available for products Central Stores stocks to the prices for identical or equivalent products under the current state contract and two WSCA contracts.

When the Central Stores pricing is compared to alternatives such as the WSCA contract, prices on some individual items remain favorable but when compared in aggregate, the WSCA contracts provide lower overall pricing. Central Stores transaction data included a total of 78 different products during the six-month time period we

WSCA Vendor 1	WSCA Vendor 2
\$30,600*	\$35,800*

*The potential savings listed above do not include an optional administrative fee. If the maximum administrative fee were included the potential savings would be reduced by approximately \$4,000-7,000.

Source: Compiled by the Legislative Audit Division from Department of Administration and vendor data.

analyzed. The total dollar value for these transactions during the time period analyzed was \$485,304. We compared the prices for 91.4 percent (measured by dollar value sold) of the products sold by Central Stores to one WSCA vendor and the WSCA vendor's entire basket of goods would have cost approximately \$30,600 less during the six-month time period. For a second WSCA vendor we were able to match 89.1 percent of the products sold and this basket would have been about \$35,800 less than was actually spent. These totals are also shown in Table 5.

Direct Delivery of Office Supplies Would Decrease Costs

The prices paid by the end-users of the state's current online ordering system are higher than alternatives because products must be marked-up in order to cover overhead and delivery by Central Stores. The markup is paid by the ordering agency as part of the product's final price. This markup causes products that were obtained at prices competitive with alternative contracts to become more expensive for the end-user. The delivery time may exceed potential alternatives because of the "double-handling" of products by the contractor and Central Stores. A direct delivery model would eliminate both the markup and the extra step in shipping.

Central Stores has provided a service for more than 30 years and continues to provide stocked products at prices that are preferable to the current state contract. State personnel indicated they are pleased with the customer service provided by Central Stores staff, but changes in the national office supply landscape now allow vendors

to provide the products that are stocked by Central Stores at generally lower prices. Montana agencies could save on office supply costs if the state awards a contract that includes products stocked by Central Stores to a vendor or vendors providing direct delivery. During the six months we reviewed the potential savings could have been as large as \$139,000. If the maximum administrative fee were included in the cost of those goods the potential savings would be reduced to approximately \$109,000.

RECOMMENDATION #1

We recommend the Department of Administration:

- A. *Seek a statewide contract for office supplies that features direct delivery of products from a vendor to the ordering agency.*
 - B. *Include the office supplies currently sold through Central Stores in a new direct delivery statewide contract for online ordering of office supplies.*
-

Chapter III – Management of Procurement Methods

Introduction

This chapter discusses the management of the office supply acquisition processes. We concluded monitoring of the contractor could be improved and additional outreach to agency personnel on purchasing office supplies is necessary. The remainder of this chapter details our findings and contains two recommendations.

Monitoring Contractor Performance

When goods and services are procured from a private contractor, there should be ongoing monitoring of the contractor's performance to ensure it is fulfilling the contract as intended. Montana state policy recommends "on a day-to-day basis, agencies need to be monitoring contract performance since early detection and correction of nonperformance is critical for the success of the contract." The office supply contract language does specify the contractor provide periodic reports of contract usage that could be used as the basis for monitoring contractor performance.

Other states use similar reports to ensure office supply vendors provide products at agreed to prices. For example, in South Dakota, the Office of Procurement Management audits monthly the contracted vendor and its services to ensure prices are accurate and the website functions correctly. In Washington, the Office of State Procurement receives monthly usage reports that list all office supply orders by line item and bill rates. That office audits these reports monthly to ensure the vendor is providing its contracted services and pricing.

In Montana, the Department of Administration (DOA) provides annual contract renewal justifications but does not detail contractor performance. The justifications typically state the contractor has performed according to the terms of the contract and is capable of performing for another year. They do not contain information related to the prices at which the contractor provided its products and whether those prices were as described in the contract. Nor do they contain an assessment of whether the contractor has met other terms and conditions of the contract, such as meeting the required delivery times or fill rates.

States Have Identified Poor Performance

Without periodic monitoring a contractor could bill at rates that are higher than those which are required by contract or the contractor may be performing poorly in terms of service or delivery time. Other states have identified problems in these areas.

North Carolina found the contracted vendor in that state inflated prices for its store brand products and failed to offer the state the lowest available prices as required by the contract and overcharged state agencies approximately \$294,000. Nebraska found its vendor was not charging the State the correct prices on some of the items it was providing and did not receive official documented approval for items they substituted or for price increases they made on items purchased by the state. An investigation in Washington determined agencies in that state paid more than \$298,000 in excess of the allowable amount per contract.

Montana is Adding Monitoring Capacity

The Department of Administration did request the statewide contractor conduct a pricing analysis prior to the most recent contract renewal. This analysis did not evaluate the contractor's performance against the terms of the contract but rather compared proposed pricing versus certain specific alternatives. The department decided to renew the contract in part based upon this analysis, which showed the proposed pricing to be lower than two alternatives.

The most recent contract renewal does contain updated, firm pricing for the current period. There is an "adjustable market basket" of goods offered at fixed prices and an array of other goods that continue to be offered at a discount from list price. The contract requires the contractor provide line item usage reports by agency and individual ordering location that indicate the number of items sold and total dollar amounts on a quarterly basis. The improvements that have been made to the contract will provide an opportunity for DOA to periodically review contractor performance. The department could use this type of report to ensure the contractor is performing as agreed but has not yet designed these processes. The department has also recently added a position with the capacity to complete such work. Previously, the department indicated it lacked the necessary resources.

RECOMMENDATION #2

We recommend the Department of Administration establish a process to coincide with contractor reporting periods to review the office supply contractor's performance in comparison to contract terms and conditions.

Outreach Could Improve Purchases From Other Retailers

Montana has had in place the statewide contract for online ordering of office supplies since February 2006 and has sold products through the Central Stores program

since 1980. Section 18-4-302(3), MCA, states agencies can purchase office supplies from alternative suppliers without competitive requirements if the price is lower than Central Stores price. It also requires a state office supply contract must allow agencies to purchase off contract if an equivalent product is available less expensively elsewhere. The current contract is exclusive, but does contain the required clause enabling agency personnel to purchase elsewhere at times. Employees of the Montana University System have optional use of the statewide contract. Otherwise, agency personnel should use the statewide contract for online ordering when possible. It appears from our analysis that procurement card transactions are not limited to those whose price is less than the price offered by the contract/Central Stores program. The following section discusses this issue further.

Use of State Procurement Cards

The total dollar value for all procurement card transactions with office supply merchants during the six-month time period analyzed was \$781,391. We compared the prices for a sample of products that were purchased using both the state website and a state issued procurement card. The sample consisted of a total of 29 commonly purchased products that were matched based upon the description included with procurement card transactions. Of these 29 products, 24 were available less expensively via the state website versus the price paid at another retailer using a procurement card. The average price advantage for these products on the state website was 11.3 percent when compared to procurement card transactions. The total spent on the 29 products we considered was \$29,504. Had the same products been purchased at the average state website price, agencies would have saved \$2,671. As mentioned previously, in spring 2011, the Department of Administration asked the contractor to compare contract prices to two alternatives, including its online retail prices for the same products. The contractor's analysis indicated that the state contract saved about 19 percent versus retail pricing.

When procurement cards are used there may also be additional time spent on the transaction. We conducted a survey of card users and they indicated for the average transaction a total of 42 minutes was spent on various transaction processes including researching price and availability, placing an order, travel to/from the vendor and other processes. If using the online ordering system, the time spent travelling to/from a vendor (estimated at 16 minutes) to complete the transaction could be eliminated.

How do State Personnel Make Purchasing Decisions?

Agency personnel indicated they use procurement cards instead of the state website for a variety of reasons. Some were unaware the statewide contract exists, others required a product immediately, and still others felt products were too expensive via the state

site. Our analysis showed some products were purchased less expensively when bought from another retailer using a procurement card but most cost more.

We conducted two surveys of state employees (excluding the university system) and asked a number of questions related to how they made office supply purchasing decisions. The first survey was sent to 931 employees who used a procurement card to purchase office supplies (385 surveys were completed). The second was sent to 689 online ordering system users (384 surveys were completed). Survey results of note included:

- ◆ 33 percent of respondents to the procurement card survey were not aware of the statewide contract for ordering office supplies
- ◆ 45 percent of procurement card users chose alternate retailers because of an immediate need for a product.
- ◆ 21 percent of procurement card users choose alternate retailers because of lower costs.
- ◆ Respondents were generally very satisfied with the convenience (60 percent very satisfied) and delivery time (74 percent very satisfied) when using the state website. Only 22 percent also said they were very satisfied with pricing available through the online ordering system.

In the previous chapter, we recommended some improvements that could decrease the costs of goods ordered through a statewide online ordering system but our analysis also showed that procurement card transactions with other retailers are not less expensive than the current state site options. It appears some procurement card transaction are made because of a lack of awareness of the statewide contract and there may be a perception prices are available at lower prices via other sources, which causes state personnel to seek alternatives.

The Department of Administration does offer biannual training related to procurement and a section of this training does address purchasing office supplies. However, 47 percent of the respondents to our survey indicated they had not received any training or guidance related to procurement of office products. Additional outreach by the Department of Administration could inform agency personnel of the existence and benefits of using the statewide ordering system.

RECOMMENDATION #3

We recommend the Department of Administration enhance communication related to the requirements and benefits of using statewide ordering systems.

DEPARTMENT OF
ADMINISTRATION

DEPARTMENT RESPONSE

DEPARTMENT OF ADMINISTRATION
DIRECTOR'S OFFICE

A-1



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October 25, 2011

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OCT 25 2011

LEGISLATIVE AUDIT DIV.

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Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620-1705

RE: Audit #11P-09: Improving Montana's Office Supply Acquisition Processes

Dear Ms. Hunthausen:

The Department of Administration has reviewed Audit #11P-09: Improving Montana's Office Supply Acquisition Processes. Our responses to the recommendations are below.

Recommendation #1

We recommend the Department of Administration:

- A. Seek a statewide contract for office supplies that features direct delivery of products from a vendor to the ordering agency.
- B. Include the office supplies currently sold through Central Stores in a new direct delivery statewide contract for online ordering of office supplies.

Response: Concur.

A & B: The Department of Administration will seek approval to contract for direct delivery of office supplies through the legislative process.

Recommendation #2

We recommend the Department of Administration establish a process to coincide with contractor reporting periods to review office supply contractor's performance in comparison to contract terms and conditions.

Response: Concur.

The Department of Administration will establish a contract review process that coincides with contractor reporting periods.

Recommendation #3

We recommend the Department of Administration enhance communication related requirements and benefits of using statewide ordering systems.

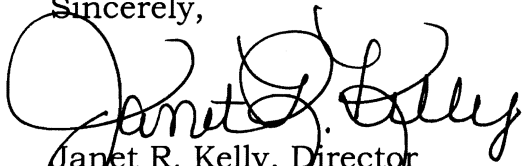
Response: Concur.

The Department of Administration will enhance its communication and outreach to state employees about the requirements and benefits of using the Central Stores online ordering system by sending quarterly messages on Outlook.

We appreciated the hard work and careful examination that you and your staff provided during this audit. Our department always looks upon the audit process as an opportunity to improve our operations and performance.

The Department's Corrective Action Plan (CAP) is enclosed.

Sincerely,



Janet R. Kelly, Director
Department of Administration

Enclosure

**Preliminary Response: Department of Administration
 Corrective Action Plan (CAP): Audit Report #11P-09
 Improving Montana's Office Supply Acquisition Processes
 October 25, 2011**

Agency	Recommendation #	Does this affect a federal program?	CFDA # (if previous YES)	Management View	CAP – Corrective Action Plan	Person responsible for CAP	Target Date
61010	Recommendation #1 We recommend the Department of Administration: A. Seek a statewide contract for office supplies that features direct delivery of products from a vendor to the ordering agency. B. Include the office supplies currently sold through Central Stores in a new direct delivery statewide contract for online ordering of office supplies	No		Concur	A&B: DOA will seek approval to contract for direct delivery of office supplies through the legislative process.	Marvin Eicholtz	12/30/2012
61010	Recommendation #2 We recommend the Department of Administration establish a process to coincide with contractor reporting periods to review the office supply contractor's performance in comparison to contract terms and conditions.	No		Concur	DOA will establish a contract review process that coincides with contractor reporting periods.	Marvin Eicholtz	4/30/12
61010	Recommendation #3 We recommend the Department of Administration enhance communication related to the requirements and benefits of using statewide ordering systems.	No		Concur	DOA will enhance its communication and outreach to state employees about the requirements and benefits of using the Central Stores online ordering system by sending quarterly messages on Outlook.	Marvin Eicholtz	4/30/12