



STATE OF NORTH CAROLINA

DEPARTMENT OF ADMINISTRATION

DIVISION OF PURCHASE AND CONTRACT

FINANCIAL RELATED AUDIT

OFFICE SUPPLIES TERM CONTRACT AUDIT FOLLOW-UP

JUNE 2014

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

EXECUTIVE SUMMARY

PURPOSE

This audit evaluates whether the Department of Administration took appropriate corrective action to address recommendations made in the *Office Supplies Term Contract Administered by the Division of Purchase and Contract* performance audit report issued by the Office of the State Auditor in September 2008.

BACKGROUND

The Division of Purchase & Contract (P&C) is North Carolina's central purchasing authority. P&C helps state agencies save money by using the volume of statewide purchases to negotiate lower prices in state term contracts.

P&C's response to the September 2008 report stated that it had "in all cases either already implemented the auditor's recommendations or is in the process of implementing them."

KEY FINDINGS

- P&C did not have documentation to show that it collected overcharges from a former office supplies vendor.
- P&C did not implement the recommendation to automate its contract monitoring procedures.
- P&C did not implement the recommendation to automate user complaint tracking procedures.
- P&C did not implement the recommendation to provide its staff with training specific to monitoring punch-out catalogs.
- P&C implemented the recommendation to identify position requirements for contract monitors.
- P&C implemented the recommendation to improve contract terms and conditions that involve the use of punch-out catalogs.

KEY RECOMMENDATIONS

- P&C should retain adequate documentation of how vendor performance issues are resolved.
- P&C should automate its contract monitoring procedures.
- P&C should automate complaint tracking procedures.
- P&C should provide its staff training specific to monitoring punch-out catalogs.

The key findings and recommendations in this summary are not inclusive of all the findings and recommendations in the report.



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State Auditor

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AUDITOR'S TRANSMITTAL

June 25, 2014

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Mr. Bill Daughtridge, Jr., Secretary, Department of Administration

This report presents the results of our financial related audit at the North Carolina Department of Administration – Division of Purchase and Contract. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the *Audit Findings, Recommendations, and Responses* section of this report.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

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

Beth A. Wood, CPA
State Auditor

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BACKGROUND

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Department of Administration – Division of Purchase and Contract (P&C).

This audit was conducted as a result of the findings reported in the September 2008 audit titled, “Office Supplies Term Contract Administered by the Division of Purchase and Contract.” The September 2008 audit evaluated the former vendor’s compliance with, and P&C’s administration of, the office supplies statewide term contract. Auditors reviewed office supplies purchased from July 1, 2007, to December 31, 2007 and found the former office supplier had overcharged state agencies \$294,413.¹

The 2008 audit recommended P&C take the following corrective action:

- 1) P&C should pursue collection of overcharges that state agencies incurred on purchases from the former office supply vendor’s online catalog.
- 2) P&C should automate its contract monitoring procedures to better ensure vendor compliance with the statewide office supplies term contract.
- 3) P&C should automate its complaint tracking procedures to better ensure vendor compliance with the statewide office supplies term contract.
- 4) P&C should implement training for contract monitoring positions.
- 5) P&C should identify position requirements for contract monitoring positions.
- 6) P&C should ensure that future office supplies term contracts identify items by product identification numbers that the vendor cannot manipulate, clearly define product categories, and provide a method to penalize vendors for poor performance.

¹ Office of State Auditor “Office Supplies Term Contract Administered by The Division of Purchase and Contract” performance audit report issued in September 2008 (PER-2008-7239).

AUDIT SCOPE AND OBJECTIVES

The objective of this financial related audit was to determine whether the Division of Purchase and Contract took appropriate corrective action to adequately address recommendations made in the “Office Supplies Term Contract Administered by Division of Purchase and Contract” performance audit report issued in September 2008.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Errors or fraud may nevertheless occur and not be detected because of the inherent limitations of internal control. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or that compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Our audit scope covers the period from January 1, 2012, to September 30, 2013.

METHODOLOGY

To accomplish our audit objectives, auditors gained an understanding of internal control over matters described in the *Audit Scope and Objectives* section of this report and evaluated the design of the internal control. Auditors then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that provide evidence about our audit objectives. Specifically, auditors interviewed personnel, observed operations, reviewed policies, analyzed accounting records, and examined documentation supporting recorded transactions and balances, as considered necessary in the circumstances.

As a basis for evaluating internal control, we applied the internal control guidance contained in professional auditing standards. As discussed in the standards, internal control consists of five interrelated components: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We also considered North Carolina General Statutes, the current office supplies term contract,² and the “State of North Carolina Contract Administration and Monitoring Guide” to identify improvements in P&C’s monitoring of statewide term contracts.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. 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.

² Term Contract No. 615A (Invitation for Bid No. 801865 for General Office Supplies), effective through February 28, 2014.

RESULTS AND CONCLUSIONS

We determined that the Division of Purchase and Contract did not take corrective action to address most of the recommendations made in the “Office Supplies Term Contract Administered by the Division of Purchase and Contract” performance audit report issued in September 2008. Our audit also identified deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the *Audit Findings, Recommendations, and Responses* section of this report. Management’s responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them.

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

OFFICE OF STATE AUDITOR RECOMMENDATIONS NOT FULLY IMPLEMENTED

The Division of Purchase and Contract (P&C) did not fully implement recommendations to improve its oversight of the office supplies contract as recommended in the September 2008 performance audit titled “Office Supplies Term Contract Administered by the Division of Purchase and Contract – Department of Administration.”

Specifically, P&C did not provide documentation to show that it recovered \$294,413 in overcharges, automate contract monitoring, automate complaint tracking, or provide training to its contract monitors specific to monitoring punch-out catalogs.³

However, P&C has implemented some recommendations. P&C developed new requirements for its contract monitor positions and is in the process of hiring qualified staff. P&C also improved the contract terms it uses, has more control over items listed in vendors’ punch-out catalogs, and includes penalty provisions for poor vendor performance in its contracts.

No Documentation To Show That Overcharges Were Recovered

P&C did not have documentation to show that it collected overcharges from a former office supplies vendor as recommended by auditors.

Consequently, auditors could not determine whether P&C recovered overcharges from the former office supplies vendor.

In 2008, auditors determined that the former vendor had overcharged state agencies \$294,413 over a six-month period by inflating prices and adding thousands of unauthorized items to the office supplies punch-out catalog. Auditors recommended that P&C pursue collection of the overcharges.

In its written response to the audit, P&C responded that “...reimbursements have been completed, so the net result is no harm to the taxpayers and the contract users.”

However, there is no documentation to support P&C’s statement. Therefore, we conclude no reimbursements occurred.

Internal control⁴ best practices require adequate documentation of transactions and events. Specifically, the Government Accountability Office recommends that:

“Documentation of transactions and other significant events is complete and accurate and facilitates tracing the transaction or event and related information from authorization and initiation, through its processing, to after it is completed.”⁵

³ Ariba, the State’s punch-out catalog developer, describes a punch-out catalog as an “An application used by a buying organization (the State) to manage and control purchasing” that allows suppliers to integrate with a buyer’s procurement system. The buyer leaves (“punches **out**”) from their company’s purchasing system and goes to the supplier’s electronic **catalog** on a remote website to find products and services while creating a purchase requisition on the buyers’ purchasing system. What is PunchOut? © 2014 Ariba, Inc.

⁴ “Internal control, sometimes referred to as management control, in the broadest sense includes the plan, policies, methods, and procedures adopted by management to meet its missions, goals, and objectives.” Government Auditing Standards, 2011

⁵ GAO, Internal Control Management and Evaluation Tool, 2001

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

Automated Contract Monitoring Not Implemented

P&C did not implement the Office of the State Auditor's recommendation to automate monitoring of price accuracy and product availability for the current office supply term contract (Contract).⁶

As a result, there is an increased risk that inaccurate prices and unauthorized changes could occur and not be timely identified and corrected.

Instead of automating its process, P&C chose to manually monitor price and product availability for the four vendors' punch-out catalogs through quarterly spot checks. The manual spot check monitoring process is similar to the process that auditors reported as inefficient and ineffective in 2008.

P&C's current manual contract monitoring process had six procedural weaknesses.

First, P&C could not show that it performed a sufficient number of manual reviews. P&C only provided evidence of one manual spot check monitoring effort for the five-year period from 2008 to 2013.

Second, P&C did not retain documentation needed to conduct a retroactive review of the vendors' compliance with price accuracy and product availability. Specifically, P&C did not retain documentation of all the Contract's quarterly price lists for four of the seven quarters (57%) within the audit period of January 1, 2012 to September 30, 2013. Consequently, neither P&C nor the auditors could retroactively compare all of the contract prices to the prices that state agencies paid.

Third, P&C did not adequately review vendors' performance reports. P&C said that it relied on the reports to monitor the vendors' contract performance. According to the Contract, vendors were required to submit performance reports to P&C on a monthly and quarterly basis. However, P&C said that it did not review or analyze these reports. Therefore, there was no mechanism to identify and follow-up on any potential issues within the reports.

Fourth, P&C did not monitor a large portion of the purchases made under the Contract. Approximately \$11.1 million (43.7%)⁷ in purchases were made outside of the State's purchasing system (E-Procurement) and cannot be readily identified or monitored by P&C. Contract award documents⁸ indicate the Contract was worth approximately \$25.4 million⁹ when prorated for our audit period. However, only \$14.3 million (56.3%)¹⁰ in office supply purchases could be identified in E-Procurement for the same period.

⁶ Term Contract No. 615A (Invitation for Bid No. 801865 for General Office Supplies), effective through February 28, 2014

⁷ \$25.4 million estimated contract spend - \$14.3 million E-Procurement purchases (for January 1, 2012 to September 31) = \$11.1 million.

⁸ North Carolina Department of Administration Canvassing Bids and Awarding Contracts Board Sheet for General Office Supplies Bid Number 801865, December 18, 2008.

⁹ The audit period was January 1, 2012 to September 30, 2013, or 21 months. \$14.5 million / 12 months x 21 months = \$25.4 million.

¹⁰ According to an E-Procurement report of purchase order details (from January 1, 2012, to September 30, 2013) on the office supplies term contract as provided by Accenture. The auditors did not test and do not opine on the reliability of the data presented in the report.

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

Fifth, P&C did not provide state agencies with the information needed to monitor vendors' performance. P&C relied on the state agencies to report pricing errors and other vendor performance issues. However, P&C did not always provide the current price list in a timely manner so that state agencies could verify that they were being charged the correct Contract price. For five out of seven quarters during the period January 1, 2012 to September 30, 2013, P&C was either late delivering the applicable price list or did not deliver it at all to state agencies.

And sixth, P&C lacked sufficient personnel to adequately monitor vendors' performance. P&C stated that staff shortages made contract monitoring a low priority. P&C further stated it made little or no attempt to fill vacant positions until December 2013 because of two separate improvement efforts¹¹ initiated during the last three years. In January 2012, eight out of the nine (88.9%) available monitoring positions were filled. By September 30, 2013, only five out of nine (55.6%) positions were filled. P&C obtained approval from Office of State Human Resources and began advertising for eight additional (12 total) positions in December 2013. However, only five out of 12 (42%) positions were staffed on January 1, 2014.

Although P&C relied on state agencies and vendors to perform certain contract monitoring functions, North Carolina General Statute prohibits P&C from delegating its contract monitoring responsibilities. Statute¹² states the Secretary of Administration has the responsibility "to monitor and enforce the terms and conditions of statewide term contracts" and "shall not delegate the power and authority to any other department, agency, or institution of the State."

In 2008, auditors recommended automating contract monitoring procedures to help ensure vendor compliance with the office supplies contract. Auditors determined that P&C's manual monitoring process was not efficient or effective to prevent the former office supplies vendor from overcharging state agencies \$294,413 and adding thousands of unauthorized items to the office supplies punch-out catalog.

Auditors cited the National State Auditor Association's "Best Practices in Contracting for Services" which states:

"Contract monitoring is an essential part of the contracting process. Monitoring should ensure that contractors comply with contract terms, performance expectations are achieved, and any problems are identified and resolved. Without a sound monitoring process, the contracting agency does not have adequate assurance it receives what it contracts for."

Automated Complaints Tracking Not Implemented

P&C did not implement the Office of the State Auditor's recommendation to automate the tracking of user complaints for the Contract. In fact, P&C did not track user complaints about prices at all during our audit period. As noted above, P&C relied on state agencies to confirm posted punch-out catalog prices for the products they ordered. However, P&C did not track any user complaints on punch-out catalog prices.

¹¹ North Carolina Procurement Transformation was initiated by the Department of Administration in 2011. In 2013, the General Assembly authorized the Reorganization Through Reduction Program in Session Law 2013-382.

¹² NCGS § 143-49 Powers and Duties of the Secretary.

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

Consequently, P&C management has no way of knowing if pricing errors are being reported, if reported errors are being investigated timely, or if reported errors are being resolved timely. Without this information, P&C cannot identify trends in the type and frequency of complaints that could indicate larger contract compliance problems.

In 2008, auditors recommended automating complaint tracking procedures so that P&C would have an efficient and effective method to track and ensure the successful resolution of state agency complaints. Auditors found that P&C did not maintain an automated database to log the date that state agencies reported a problem, log the date that P&C communicated the problem to the vendor, categorize problems by type, document each problem's resolution, or document that state agencies received the credits due to them.

Auditors also cited the National State Auditor Association's "Best Practices in Contracting for Services" which states, "Monitoring should ensure that contractors comply with contract terms...and any problems are identified and resolved."

Training for Punch-out Catalog Monitoring Not Implemented

P&C did not implement the Office of the State Auditor's recommendation to provide its staff with training specific to monitoring punch-out catalogs. P&C provided its staff training on procurement and contract monitoring in January and April 2013. However, no training was provided specifically for monitoring punch-out catalogs.

Therefore, there is an increased risk that contract administrators could fail to detect vendor noncompliance. The lack of training also increases the risk that the State will not achieve the cost-savings for which it negotiated.

In 2008, auditors recommended training specific to monitoring punch-out catalogs because of the unique risks that punch-out catalogs present. As P&C stated in its response to the September 2008 audit,

"Though very convenient for ordering supplies, the downside is that these punch out catalogs are loaded with pricing which can be changed quickly and even unintentionally by involved third parties."

To support the recommendation, auditors also cited "Best Practices in Contracting for Services" which states,

"To properly monitor a contract, the agency should ensure that the contract manager possesses adequate skills and has the **necessary training** to properly manage the contract." (Emphasis added)

Position Requirements for Contract Monitors Identified

P&C implemented the Office of the State Auditor's recommendation to formally document the knowledge, skills, and abilities that employees need to effectively monitor state contracts.

The additional requirements should help ensure that P&C recruits qualified personnel to effectively monitor punch-out catalog contracts.

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

In the fall of 2013, P&C identified new position requirements for contract monitoring positions. The new position requirements include specific requirements about experience with E-Procurement or other procurement software functionality. Additionally, the new requirements call for professional certification in contract administration.

In 2008, auditors recommended that P&C identify the knowledge, skills, and abilities that employees need to effectively monitor state contracts. To support the recommendation, auditors also cited “Best Practices in Contracting for Services” which states,

“To properly monitor a contract, the agency should ensure that the contract manager **possesses adequate skills** and has the necessary training to properly manage the contract.” (Emphasis added)

Contract Terms Improved

P&C implemented the Office of the State Auditor’s recommendation to improve the terms and conditions used in its contracts that involve the use of punch-out catalogs.

P&C included terms in the current office supplies contract that auditors recommended in the September 2008 audit report. The current contract provides the State greater control over product identification numbers, category descriptions, and prices listed in the vendors’ punch-out catalogs.

P&C also included penalty provisions for poor vendor contract performance. According to the Contract, vendors who deviate from the contract price file will have their selling privileges suspended or removed. The State may also take actions to recoup overcharges without allowing vendors to offset overcharges with undercharges.

The new contract terms should help P&C to better control the online punch-out catalogs and hold vendors accountable for poor performance.

In 2008, auditors recommended that P&C improve the terms of future contracts to protect the interest of the State. Auditors found that the previous contract did not include terms and conditions necessary to give P&C adequate control over product identification numbers, product categories, and vendor performance. As a result, the contract did not adequately address the complexities of managing an online punch-out catalog.

RECOMMENDATIONS:

P&C should adequately document how vendor performance issues are resolved. P&C should retain this documentation in accordance with contract record retention requirements.

P&C should automate contract monitoring procedures to ensure vendor compliance with the Contract.

P&C should automate complaint tracking procedures so that P&C would have an efficient and effective method to track and ensure successful resolution of state agency complaints.

AUDIT FINDINGS, RECOMMENDATIONS, AND RESPONSES

P&C should provide training specific to monitoring punch-out catalogs so contract administrators will be able to detect vendor noncompliance and ensure the State achieves the cost-savings for which it negotiated.

AGENCY RESPONSE:

The Department of Administration's Division of Purchase and Contracts (P&C), concurs with the auditors' concerns stemming from problems in 2008 which remained largely unresolved through 2013.

Automation of vendor performance and complaint tracking is under development and will be implemented fully by the end of 2014. The new Compliance Section will be charged with documenting the issues, tracking them, ensuring successful resolution of issues, and retaining the data. The State Purchasing Officer is responsible for the full implementation of this improvement.

P&C is working on the implementation of punch-out catalog audit functionality available with the Ariba Buyer software to ensure compliance with term contract pricing. A secondary manual review will be conducted regularly by the Compliance Section. The State Purchasing Officer is responsible for the full implementation of this improvement by the end of FY 14-15.

A new training program has been developed with P&C and in agreement with OSHR to certify P&C staff through NIGP training to be held onsite beginning in June 2014. P&C will continue to offer NC procurement related training, including Contract Administration to State procurement professionals. This training will include awareness of new punch-out catalog functionality and procedures. The State Purchasing Officer is responsible for the full implementation of this improvement by the end of FY 14-15.

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APPENDIX



North Carolina Department of Administration

Pat McCrory, Governor

Bill Daughtride, Jr., Secretary

June 19, 2014

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

In connection with your follow-up audit of the Office Supplies Term Contract of the Department of Administration, Division of Purchase and Contracts as of June 13, 2014 and for the period January 1, 2012, to September 30, 2013, we offer the following response to your recommendations. We appreciate the opportunity to continue to improve Purchasing and Contracts for the State of North Carolina.

The Department of Administration's Division of Purchase and Contracts (P&C), concurs with the auditors' concerns stemming from problems in 2008 which remained largely unresolved through 2013. The new Secretary of the Department of Administration authorized a complete overhaul of the Purchasing and Contracts Division during 2013. A new COO, a new Deputy Secretary, and a new State Purchasing Officer were hired and they have been working diligently to transform P&C. Utilizing Reduction Through Reorganization (RTR) they have substantially changed the staffing, the structure, and the focus of Purchasing and Contracts.

A substantial part of the restructure includes creating a new culture of customer service as well as the new Contracts Section and Compliance Section to address the legislative concerns and those in this audit. During the first 6 months of 2014, twenty-three (23) of thirty-eight (38) positions have turned over and many were reclassified to increase the level of expertise while other job duties were completely redeveloped to further emphasize contract monitoring.

Automation of vendor performance and complaint tracking is under development and will be implemented fully by the end of 2014. The new Compliance Section will be charged with documenting the issues, tracking them, ensuring successful resolution of issues, and retaining the data. The State Purchasing Officer is responsible for the full implementation of this improvement.

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APPENDIX

Page 2
State Auditor Beth Wood
June 19, 2014

A new emphasis has also been placed on technology and training. P&C is working on the implementation of punch-out catalog audit functionality available with the Ariba Buyer software to ensure compliance with term contract pricing. This change in functionality will alert users when a price deviates from the contractually agreed to pricing and adds an approval role to the requisition. The vendor will be notified so the issued can be resolved appropriately. A secondary manual review will be conducted regularly by the Compliance Section. The State Purchasing Officer is responsible for the full implementation of this improvement by the end of FY14-15.

A new training program has been developed with P&C and in agreement with OSHR to certify P&C staff through NIGP training to be held onsite beginning in June 2014. Purchasing agents from other Departments throughout State government were offered the opportunity to attend as well. P&C will continue to offer NC procurement related training, including Contract Administration to State procurement professionals. This training will include awareness of new punch-out catalog functionality and procedures. The State Purchasing Officer is responsible for the full implementation of this improvement by the end of FY14-15.

Thank you for the opportunity to respond to your recommendations. We welcome the continued dialog to further improve the services provided by the Purchasing and Contracts Division.

Sincerely,



Bill Daughtridge, Jr., Secretary

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ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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This audit required 1,765 audit hours at a cost of \$134,140.