



# STATE OF NORTH CAROLINA

## PERFORMANCE AUDIT

**OFFICE SUPPLIES TERM CONTRACT ADMINISTERED BY THE  
PURCHASE AND CONTRACT DIVISION**

**DEPARTMENT OF ADMINISTRATION**

**MAY 2007**

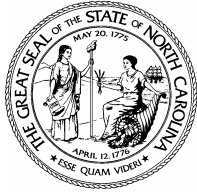
**OFFICE OF THE STATE AUDITOR  
LESLIE W. MERRITT, JR., CPA, CFP  
STATE AUDITOR**

**PERFORMANCE AUDIT**

**OFFICE SUPPLIES TERM CONTRACT ADMINISTERED BY THE  
PURCHASE AND CONTRACT DIVISION**

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Leslie W. Merritt, Jr., CPA, CFP  
State Auditor

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May 7, 2007

The Honorable Michael F. Easley, Governor  
Members of the North Carolina General Assembly  
Mr. Britt Cobb, Secretary, North Carolina Department of Administration

Ladies and Gentlemen:

We are pleased to submit this performance audit entitled *Office Supplies Term Contract Administered by the Purchase and Contract Division*. The objective of the audit was to determine whether the Purchase and Contract Division was effectively monitoring vendor performance of the Statewide term contract for office supplies. Secretary Cobb has reviewed a copy of this report. His written comments are included after the audit finding.

We wish to express our appreciation to the staff of the Department of Administration for the courtesy, cooperation, and assistance provided us during the audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Leslie W. Merritt, Jr.".

Leslie W. Merritt, Jr., CPA, CFP  
State Auditor

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# **PERFORMANCE AUDIT**

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## **SUMMARY**

The Purchase and Contract (P&C) Division operates within the Department of Administration and provides centralized purchasing services for the State of North Carolina. P&C's major responsibilities include bidding, negotiating, establishing and monitoring of statewide term contracts. Statewide term contracts are used generally to establish suppliers and prices of a given commodity, group of commodities, or services. These contracts typically cover a period of multiple years and consolidate normal requirements of all agencies into one or a small number of agreements.

On January 30, 2003, P&C awarded statewide term contracts for office supplies to four vendors. In September 2005, P&C re-bid the office supply contract and subsequently awarded a three-year contract to one vendor, Office Depot, effective February 1, 2006.<sup>1</sup>

The objective of the audit was to determine whether P&C was effectively monitoring vendor performance of the statewide term contract for office supplies, specifically:

1. Did quoted catalog prices and actual prices charged agree with the prices stated in the contract;
2. Were the items offered under the contract available for purchase?

### **RESULTS IN BRIEF**

While P&C's monitoring of the office supplies contract had identified and addressed errors, no evidence was provided that P&C attempted to identify and correct the underlying cause(s) of the errors, a process that we consider an essential part of P&C's responsibility of monitoring statewide term contracts. Pricing errors in the vendor catalog continued to exist, even though P&C was aware of the problem and had addressed known individual pricing errors, including some that resulted in overcharges to state agencies. Additionally, a number of items covered under the contract were not available for purchase through the vendor. In the absence of permanent, reliable corrective action, state agencies' assurance that contracted items are available, at contracted prices, is compromised.

### **DEPARTMENT'S RESPONSE**

The response from the Department of Administration is included in the appendix.

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<sup>1</sup> This contract was subsequently terminated by P&C, re-bid, and on December 7, 2006, a new contract was awarded to Office Depot.

## INTRODUCTION

### BACKGROUND

The Purchase and Contract (P&C) Division operates within the Department of Administration and provides centralized purchasing services for the State of North Carolina. P&C's major responsibilities include bidding, negotiating, establishing and monitoring of statewide term contracts.

Statewide term contracts are used generally to establish suppliers and prices of a given commodity, group of commodities, or services without specifying the quantity of commodities involved. They typically cover a period of multiple years and consolidate normal requirements of all agencies into one or a small number of agreements.

In 2000, the State contracted with Accenture, a technology services provider, to develop E-Procurement, an on-line purchasing system. The E-Procurement system provides P&C and other state purchasing agencies with the capability to create and view electronic requisitions and to automate purchasing approvals. When a vendor offers an on-line catalog, E-Procurement can provide access to that catalog so that goods and services can be ordered electronically by authorized personnel.

P&C currently has 125 statewide term contracts representing a value of \$1.4 billion in awarded contracts with over 400 vendors. Four of these statewide term contracts use the vendors' electronic catalogs in conjunction with the E-Procurement system's "punch-out" feature. These four contracts represent \$96 million in awarded dollars over their contractual periods. The statewide term contract for office supplies is an example of a contract that uses E-Procurement's punch-out feature.

On January 30, 2003, P&C awarded statewide term contracts for office supplies to four vendors: Corporate Express, GetItQuick.com, Piedmont Office Supplies, and Staples, Inc. P&C continued to extend these contracts through January 31, 2006. In September 2005, P&C re-bid the office supply contract and subsequently awarded a three-year contract to one vendor, Office Depot, effective February 1, 2006.<sup>2</sup> The office supply contracts in effect from 2003 to 2005 were awarded at approximately \$16 million per year. The office

#### **Electronic Purchasing Using the North Carolina E-Procurement System**

A purchasing agent can create an electronic purchase requisition by utilizing product and pricing information from a supplier's on-line vendor catalog. This is made possible using the North Carolina E-Procurement system's ability to "punch out" to a supplier's web site.

- The buyer logs into the E-Procurement system with a username and password. After a successful login, the buyer is directed to the supplier's website.
- Using the searching tools of the supplier's North Carolina punch-out site, the user will select the desired products and services. A supplier's on-line catalog may include the price, availability and visual representation of the item.
- When the order is complete, the user will exit the supplier's punch-out site and the shopping cart will be brought back to the North Carolina E-Procurement system.
- An order is not submitted to a supplier until the buyer has actually added the items to a purchase order, the purchase order is approved, and it is sent to the supplier. Prices of items ordered through punch-out sites are not checked by the E-Procurement system to see whether they agree with the contract prices.

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<sup>2</sup> See footnote 1.

## **PERFORMANCE AUDIT**

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supply contract with Office Depot was awarded for an estimated \$18.2 million for 2006 and for \$17.4 million for 2007.

North Carolina Administration Code (01 NCAC 05B.1101) prohibits agencies from purchasing any commodities, printing, or services covered by a statewide term contract from any source other than the vendor or vendors who are awarded the contract. Selected exceptions to this rule are emergency or pressing need situations, exemptions or special delegations.

P&C contract administrators have the responsibility of monitoring statewide term contracts. A primary function of the contract administrator is to enforce the contract's terms and conditions, including product price and availability. Each contract administrator is assigned to one or more statewide term contracts.

### **OBJECTIVES, SCOPE, AND METHODOLOGY**

This audit of the P&C Division was undertaken at the direction of the State Auditor. The objective of the audit was to determine whether P&C was effectively monitoring vendor performance of the statewide term contract for office supplies, specifically:

1. Did quoted catalog prices and actual prices charged agree with the prices stated in the contract;
2. Were the items offered under the contract available for purchase?

The scope of our audit included an analysis of both the previous and present contracts and covered the period from July 1, 2004, to September 15, 2006. We compared the current vendor's on-line catalog quoted prices as well as actual prices paid to the prices stated in the statewide term contract. Additionally, we reviewed data compiled by P&C relating to the availability of items in the current vendor's on-line catalog. Since on-line catalogs were no longer available for vendors under the previous contracts, we limited our review to an analysis of actual prices paid compared with prices stated in those contracts.

This report contains the results of the audit including conclusions and recommendations. Specific recommendations related to our audit objectives are reported. Because of the test nature and other inherent limitations of an audit, together with the limitations of any system of internal and management controls, this audit would not necessarily disclose all weaknesses in the systems or lack of compliance.

Our fieldwork took place from August 10, 2006, to December 12, 2006. We conducted this audit under the authority vested in the State Auditor by North Carolina General Statute 147-64.6 and according to generally accepted government auditing standards.

## **FINDINGS AND RECOMMENDATIONS**

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### **THE PURCHASE AND CONTRACT DIVISION DID NOT REQUIRE THE VENDOR TO PERMANENTLY CORRECT CAUSES OF ERRORS IN PRICING AND AVAILABILITY FOR THE OFFICE SUPPLIES STATEWIDE TERM CONTRACT**

The Purchase and Contract Division (P&C) has not instituted permanent, corrective action for known pricing errors and product availability issues caused by its office supplies vendor, Office Depot. Through its internal monitoring process, P&C found pricing errors in the vendor's catalog and overcharges by the vendor and uncovered a number of items required by the contract that were not available for ordering. However, P&C did not require the vendor to determine the underlying causes for the errors or to present any course of action to prevent future occurrences. In the absence of permanent, reliable corrective action, state agencies' assurance that contracted items are available, at contracted prices, is compromised.

#### **Incorrect Vendor Catalog Prices**

P&C's punchout guidelines for monitoring the office supplies term contract did not clearly, and in specific terms, define remedial actions to be taken when price discrepancies are uncovered between catalog and contract prices. The guidelines do not state, for example, how long the vendor should be given to make corrections, subsequent follow-up procedures to employ to ensure the vendor has instituted permanent corrective action, and the actions to take if a vendor fails to remedy contractual non-compliance.

P&C intermittently performs manual comparisons between the vendor's on-line catalog prices and the statewide term contract prices. When price discrepancies are identified, the P&C contract administrator notifies the vendor. (Our testing of catalog prices for all 582 "core"<sup>3</sup> items revealed a 6.5% error rate, with unit prices ranging from \$.60 to \$199.75 in excess of contract prices.) However, P&C did not engage with vendor management to determine the root causes for price discrepancies that it had uncovered. More importantly, P&C did not follow through to ensure permanent corrective action was implemented by the vendor. This compromises the integrity of the pricing data that purchasers view on the vendor's on-line catalog when ordering office supplies through the E-Procurement system.

#### **Overcharges**

P&C does not have an automated, real-time system in place to check purchase prices against contract prices when purchase orders are placed. In response to a request from the State Auditor's Office, Office Depot identified incorrect prices on 1,577 transactions resulting in overcharges of \$40,887<sup>4</sup>. Office Depot acknowledged that the overcharges should be refunded to the buying entities and advised P&C that it had initiated credits to the affected state agencies.

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<sup>3</sup> "Core" items are those catalog items that have historically consumed the greatest number of dollars. As such, errors within this category are more likely to have the greatest cost impact to the State.

<sup>4</sup> These amounts include overcharges to state agencies, universities, community colleges, public schools, local governments and other miscellaneous entities and include all methods of payment.



## **FINDINGS AND RECOMMENDATIONS**

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We have additional concerns related to overcharges:

- Our tests have disclosed that the Office Depot analysis is incomplete. We have identified overcharges that were not included in the Office Depot analysis.
- P&C did not verify the Office Depot analysis disclosing overcharges.
- P&C was notified of the overcharges in September 2006, but it was not until January 2007 that P&C determined the status of the refunds identified by Office Depot.
- P&C has not notified state agencies and other entities of the credits they are due from Office Depot.

It should be noted that overcharges are not unique to the Office Depot contract. We found overcharges had also occurred in the prior office supply contracts. A review of transactions from the four former office supply vendors also revealed pricing errors, with unit prices ranging from \$.02 to \$18.00 in excess of contract prices.

### **Product Availability**

P&C's internal process of comparing vendor catalog prices with the statewide term contract prices revealed that 117 office supply items listed in the contract were not available for purchase by state agencies.

As in the case with price discrepancies, a contract administrator stated that the issue was communicated to Office Depot representatives. However, P&C did not follow through to ensure that the vendor implemented permanent, corrective action. As such, P&C's ability to provide assurances that authorized buyers will be able to obtain items required by the statewide term contract is compromised. This increases the likelihood that buyers will either find substitute items or go outside of the contract to another vendor, possibly paying higher prices.

### **Problem Analysis Summary**

The Purchase and Contract Division has not instituted permanent corrective action for the aforementioned pricing errors and product availability issues caused by its office supplies vendor. Permanent corrective action requires an understanding of the root causes of the problems, the corrective actions that have been taken, and what preventative actions will be necessary to prevent similar problems in the future. P&C should ensure that its employees are made aware of the problems and how they should conduct their activities differently, if necessary. Once reasons for problems are understood, risks that these same problems may take place in the future may warrant focused monitoring of events. For example, Office Depot indicated that some mistakes to the state's prices occurred because of its update of the catalog in June 2006. This event could occur again at the next annual update of the catalog in June 2007. More monitoring immediately after this event may help ensure that potential problems do not occur or, if they do, that they are addressed in a timely manner.

## FINDINGS AND RECOMMENDATIONS

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This approach to problem analysis is significantly different from simply receiving a response that identified problems have been fixed. Supporting reasons for and circumstances surrounding the problems and how corrective actions by both the vendor and P&C will likely prevent future occurrence of the problems are important elements that should also occur. Adequate communication among P&C, the vendor, and affected state agencies is necessary to facilitate this type of problem analysis. It requires that P&C is more proactively involved in the problem resolution process and that monitoring procedures and management practices are instituted to prevent or resolve such problems in a timely manner.

**Recommendations:** P&C should strengthen its monitoring procedures related to vendor performance of the statewide office supply term contract. Specifically,

- Management should be more actively engaged in resolving problems with its statewide office supply term contract. Fixes should not just address the apparent and known effects of problems but should be based on an investigative and thorough review of problems and should address their root causes.
- P&C should establish better controls related to the monitoring of vendor performance. These controls should include written procedures that provide specific criteria for monitoring vendor catalog prices, vendor payments, and availability of products. Procedures should also address the timely follow-up of discrepancies as well as senior management's responsibilities in the resolution of on-going issues.
- P&C should verify the completeness of Office Depot's analysis disclosing overcharges. P&C should notify state agencies and other entities of the credits that they are due from Office Depot.
- P&C should explore methods of implementing automated internal checks designed to 1) identify price discrepancies within the E-Procurement system before the issuance of purchase orders and 2) periodically check the vendor's on-line catalog for product availability.



## North Carolina Department of Administration

Michael F. Easley, Governor

May 3, 2007

Britt Cobb, Secretary

Hon. Leslie W. Merritt, Jr., CPA, CFP  
State Auditor  
Office of the State Auditor  
20601 Mail Service Center  
Raleigh, NC 27699-0601

**Re: Office Supplies Term Contract Administered by the  
Purchase and Contract Division**

Dear Mr. Merritt:

On April 10, 2007, the Department of Administration received your revised draft report on the performance audit of the Office Supplies Term Contract. This revised draft followed discussions between the Division of Purchase and Contract and your staff. The Division of Purchase and Contract examined your office's findings and recommendations and prepared the attached response addressing your office's concerns and supporting your recommendations.

The Department of Administration remains committed to the effective and efficient management of all contracts administered by the Division of the Purchase and Contract. We anticipate that your office's recommendations will assist us in that objective of improved business practices.

The Division has worked tirelessly leading to the award of the February 2007 Office Supplies Term Contract. This contract continues to lower the cost of office supplies for state agencies and eligible institutions by providing the State a discount of 71% off retail prices for office supplies – a significant savings to the taxpayers of North Carolina. I trust you share my appreciation for their efforts.

If there are questions or comments, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Britt Cobb", written over a white background.

Britt Cobb

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**RESPONSE TO PERFORMANCE AUDIT**

***OFFICE SUPPLIES TERM CONTRACT ADMINISTERED BY THE  
DIVISION OF PURCHASE AND CONTRACT***

April 2007

**SUMMARY**

The Division of Purchase and Contract has done an exemplary job in the management of this contract to the benefit of the taxpayers of the State of North Carolina through a highly competitive bidding process that has resulted in substantially lower costs on office supplies purchased by state agencies. It should be noted that the Department of Administration does not concur completely with several conclusions and statements made in the Results in Brief and other sections of the audit as explained further. However, the Division of Purchase and Contract supports the Auditor's recommendations for continuing improvements and will take the necessary steps for implementation.

Like all customers, the Division of Purchase and Contract and all state agencies expect a vendor to adhere to the contract prices, to notify the users of any pricing errors, and, within reason, to make sure that every contract item is available. For that reason, the Division of Purchase and Contract monitors all contracts for which it is responsible in order to identify and correct pricing errors and investigate any unavailable items. This process is more straightforward when the Division of Purchase and Contract retains all access to the purchasing system used for the contract. As the Auditor is aware, web based, "punch-out" catalogs are unique purchasing systems in that the Division of Purchase and Contract must rely on the vendor to post correct prices and to avoid unintentional pricing errors. Given this unique purchasing system, the Division of Purchase and Contract recognized the need for continual monitoring of the contract and instituted such a process. As the use of web based, "punch-out" catalogs increases, the Division of Purchase and Contract expects that a fully automated, real-time system for administration of these types of contracts will become available. In the meantime, the Division of Purchase and Contract will continue to manually check and verify pricing and availability.

## INTRODUCTION

### **Supplemental Background Information**

The information below on prior and current Office Supplies Term Contracts is provided to complement the Department of Administration's response and aid in a better understanding of one of the most complex State term contracts.

The Auditor's report references the Statewide term contract for office supplies awarded January 30, 2003, to four (4) vendors. This contract was extended through January 31, 2006. The contract in place prior to January 30, 2003, was awarded to eleven (11) vendors. The Division of Purchase and Contract recognized the need for more competitive pricing and a more efficient method to administer the office supply contract. This decision was based on a thorough review of the marketplace as related to national governmental contractual arrangements which indicated that efficiencies and potential cost savings were available by reducing the number of awarded vendors. Thus, the number of vendors on the contract was reduced from eleven to four to obtain competitive pricing and a more efficient way to administer the office supply contract by streamlining managerial administration, reducing confusion and increasing quality of service for the end-users (state agencies, universities, community colleges, public schools, and other eligible participants).

In September 2005, the Division of Purchase and Contract re-bid the office supply contract and subsequently awarded a three-year term contract to one vendor. This contract was in place from February 2006 through February 2007. This contract allowed for even more streamlining and efficiency in regards to the administration of the office supply contract, placed additional requirements on the vendor for reporting, and included procedures to monitor pricing. The contract also eliminated time and effort on behalf of the end-users who previously had been forced to search multiple vendors' online catalogs for the best price on the same item.

As a result of Purchase and Contract's decision to increase competition for the Office Supplies Term Contract, the 2006 contract resulted in projected savings of \$4,500,000 over the prior contract (a 19% decrease in overall contract pricing). The actual amount of purchases from the most recent year of the 2003-2005 contract, plus estimated potential sales of additional items such as toner cartridges and small business equipment added to the 2006 contract, was in excess of \$23 million. This figure served as the baseline for comparison with the 2006 contract awarded at \$18.2 million. The decrease was a result of the deeper discounts offered with the new contract.

There were protests and eventual litigation with one vendor over the award. Subsequently, the Department of Administration re-bid the office supply contract. The contract was re-bid in September 2006 and, again in the interest of competitive pricing and efficiency, was awarded to one vendor. This solicitation made use of a simplified evaluation procedure and resulted in no bidder protests. Additional savings of approximately \$900,000 were realized over and above the projected \$4,500,000 saved in the previous contract. This resulted in an overall projected 23% decrease in the cost of office supplies or potential dollar savings of \$5,350,000 as compared to the 2003 contract. This contract was awarded on February 1, 2007 and has been implemented.

## APPENDIX

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### FINDINGS AND RECOMMENDATIONS

As with all contracts for which it is responsible, the Division of Purchase and Contract communicated with the vendor when it discovered pricing errors. The point of this communication was to find out why there were pricing errors. After the initial meeting with the vendor, additional errors were discovered. The Division of Purchase and Contract continued to investigate and supervise the vendor's performance. As the Auditor learned, this is a highly complex and multifaceted contract to administer and requires continuous monitoring to ferret out irregularities and errors.

The Audit report references that the vendor failed to ensure the availability of 117 of the 25,000 different office supply items. The Division of Purchase and Contract understands that the report's reference to unavailable items was derived from a document that the Division of Purchase and Contract prepared prior to the audit. The document was prepared as part of the Division of Purchase and Contract's management of the contract. This document contained a list of contract items that the Division of Purchase and Contract identified for suspected problems and had flagged for further review. As with any pricing errors, the Division of Purchase and Contract continues to monitor the vendor's performance on the availability of the 25,000 different office supply items within this contract.

In summary, management is very proactive in identifying and correcting known problems. Employees have been actively involved all through the audit process and are highly aware of the issues and concerns expressed by the audit. Continuous monitoring and communication with the vendor will eliminate many of the issues cited. Responses to the audit recommendations are addressed further.

### RESPONSE TO RECOMMENDATIONS

Management should be more actively engaged in resolving problems with its statewide office supply term contract.

The Department of Administration and the Purchase and Contract Division recognize that there is always room for improvement in the day-to-day functions and the execution of responsibilities of a division level office. As problems are identified they are addressed at the appropriate level of authority. If resolution is not achieved, the Department maintains a chain of authority that can be called upon to assist with any problem resolution. With a new office supplies term contract awarded February 1, 2007, additional enhancements in regard to being more proactive with problems, issues, and pricing errors have been implemented. These issues are being addressed in greater detail as part of the administration of the new term contract.

## APPENDIX

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P&C should establish better controls related to the monitoring of vendor performance.

The Division of Purchase and Contract does have written instructions/ documentation in place to properly monitor price changes. However, it is agreed that improvements can be made. Formal written procedures will be put in place to ensure that proper internal controls are communicated, implemented, and monitored. The existing procedures and instructions are being updated and expanded.

P&C should verify the completeness of Office Depot's analysis disclosing overcharges, and should also notify state agencies and other entities of the credits that they are due from Office Depot.

The Division of Purchase and Contract agrees with this recommendation and is verifying the completeness of the Office Depot analysis to assure that all overcharges are identified. The Division of Purchase and Contract has notified and advised users concerning the credits due from Office Depot.

P&C should explore methods of implementing automated internal checks.

The Division of Purchase and Contract agrees with the Auditor's report that an automated system needs to be developed to easily check for any changes in the products offered. NC E-Procurement @ Your Service includes an automated tool, which is used to verify and approve pricing on the vast majority of term contract catalogs. The vendor's on-line catalog for the office supply contract is in a different format which cannot be checked with the automated tools currently used for most term contracts. As communicated to the Auditor's staff, the Division of Purchase and Contract has previously explored automation of price checking for the office supply contract. However, upon the recommendation of this audit, the Division of Purchase and Contract will renew the investigation of available automated checking. Until such a system is developed, the staff will continue to manually check and verify pricing and availability.



## ORDERING INFORMATION

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