

# STATE OF NORTH CAROLINA

**PERFORMANCE AUDIT**

**DEPARTMENT OF ADMINISTRATION,  
DIVISION OF PURCHASE AND CONTRACT**

**STATE TERM CONTRACTING PROCESS**

**OCTOBER 2010**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

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STATE OF NORTH CAROLINA  
Office of the State Auditor

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October 21, 2010

The Honorable Beverly E. Perdue, Governor  
Members of the North Carolina General Assembly  
Moses Carey, Jr., Secretary of Department of Administration

Ladies and Gentlemen:

We are pleased to submit this performance audit titled *State Term Contract Monitoring*.

The audit objectives were to determine whether Department of Administration, Division of Purchase and Contract monitoring procedures are effective to ensure (1) state agencies comply with state term contracts and (2) the State maximizes cost savings from state term contracts. Secretary Carey reviewed a draft copy of this report. His written comments are included in the appendix.

The Office of the State Auditor initiated this audit to improve the effectiveness of the state term contract management.

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 "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

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**SUMMARY**

**PURPOSE**

This audit evaluated the effectiveness of management systems to ensure compliance with state term contract requirements and maximize cost savings. We make recommendations so Department of Administration, Division of Purchase and Contract management can take appropriate action.

**RESULTS**

*North Carolina General Statute 143-49* establishes the Department of Administration (Department) as the State's central purchasing authority. Furthermore, *North Carolina General Statute 143-55* generally requires state agencies to purchase supplies, materials, and equipment from contracts established by the Department. The Division of Purchase and Contract (P&C) within the Department provides oversight of state term contracts. However, there are three significant weaknesses in the state term contract process.

First, current practices limit P&C's ability to use the NC E-Procurement system to enforce and monitor compliance with state term contracts. One limitation is that vendor and price information is not always loaded into the NC E-Procurement system in a timely manner. For example, two contracts were not loaded into the NC E-Procurement system 18 months after the contracts were established. As a result, a state agency may fail to comply with a state term contract because the agency is not aware that a contract exists. Another limitation is that the E-Procurement system allows state agencies to purchase from a non-state term contract vendor without electronically documenting the reason for noncompliance. This allows agencies to circumvent the state term contract process without being detected by P&C in a timely manner. Still another limitation is that the NC E-Procurement system does not ensure state agencies enter accurate and complete requisition information. The lack of accurate requisition information makes it difficult for P&C to identify agency noncompliance or measure savings realized from state term contracts.

Second, P&C monitoring procedures are not efficient or effective for detecting widespread noncompliance with the state term contracting process. The primary method P&C uses to detect noncompliance with state term contracts is to review a sample of an agency's requisitions to identify instances of noncompliance. However, the reviews were not comprehensive enough to detect widespread noncompliance or to estimate the total rate of noncompliance throughout state government.

Third, P&C has negotiated state term contracts for products with multiple vendors at different prices. The use of multiple vendors on state term contracts limits potential savings because state agencies do not always purchase these products from the vendor offering the lower price. Awarding state term contracts to multiple vendors also limits the effectiveness of the process because vendors cannot reliably predict sales volume, which limits their ability to provide the lowest price.

## **PERFORMANCE AUDIT**

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### **RECOMMENDATIONS**

To ensure compliance with state term contracts, P&C should load state term contract information into the NC E-Procurement system in a timely manner. P&C should also consider using system edits in NC E-Procurement. System edits can be used to require state agencies to consider a state term contract vendor and to electronically capture the reasons for any noncompliance. System edits can also ensure that accurate procurement data is collected from state agencies that can be used to evaluate cost savings realized from the use of state term contracts.

To ensure adequate monitoring of state term contracts, P&C should consider using NC E-Procurement functionality that allows agencies to electronically document reasons for not using the applicable state term contract. Ready access to documented reasons for noncompliance can improve monitoring of the state term contracting process. For example, information from this documentation can be used to identify goods and services appropriate for future state term contracts. Also, this information can be used to better allocate compliance monitoring resources to state agency procurement processes with indications of significant noncompliance or ineffective procurement processes.

P&C should establish and document criteria and a methodology for determining when to use a single vendor versus multiple vendors for a state term contract. While there may be legitimate reasons for using multiple vendors, such as efficiencies associated with vendor's geographical proximity, these reasons should be documented. Unless otherwise directed by the Legislature, use of multiple vendor awards should be limited to goods and services meeting these established criteria.

### **AGENCY'S RESPONSE**

The Agency's response is included in the appendix.

## **INTRODUCTION**

### **BACKGROUND**

State term contracts establish suppliers and prices for selected goods and services for a period of time without guaranteed purchase quantities. State term contracts also consolidate normal requirements of all agencies into one agreement. North Carolina law requires that state term contracts be utilized by all state agencies for purchases of applicable goods and services.<sup>1</sup>

One of the primary objectives of the state term contracting process is to achieve increased value from the goods and services purchased by state agencies. This is achieved by leveraging the volume of statewide purchases of selected goods and services to obtain lower prices. Vendors are encouraged to provide lower costs in exchange for assurances that all state agency purchases for the associated goods or services will utilize the selected vendor. Any associated reductions in profit margin will therefore be made up with increased purchase quantities.

In addition to providing increased value for purchased goods and services, the state term contracting process can also serve to improve the efficiency of the state agency procurement processes. State agencies can reduce procurement costs for commonly purchased goods and services through utilization of state term contracts because cost associated with competitive bidding requirements are significantly reduced or eliminated.

For the state term contract process to be effective, vendors and the State need assurances that state agencies will utilize only selected vendors. Documented sales volumes and high compliance rates mean vendors can confidently rely on historical sales volume to calculate competitive state term contract bids. To maximize cost savings, P&C needs assurances that state agencies are utilizing state term contracts to purchase all applicable goods and services.

In Fiscal Year 2008-09, 340,761 requisitions with a value of over \$3.7 billion were processed through the state on-line purchasing system, NC E-Procurement. State agencies reported purchasing over \$593 million in goods and services from 173 state term contracts.<sup>2</sup>

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<sup>1</sup> As specified in *North Carolina General Statutes* [143-55](#). However, an exception is specified in *North Carolina Administrative Code* 01-5B.1105. In situations where a general type of item is covered by a term contract but a special type item is needed for a particular application, the agency may proceed with the purchase of the special type item. The need for the special type item in lieu of the general type item shall be justified by the agency in writing and the agency file documented for public record.

<sup>2</sup> Most of these contracts (150) are established and administered by P&C. The Office of Information Technology Systems (ITS) is responsible for the administration of 23 state term contracts. State term contracts administered by ITS are associated with goods and services relating to information technology. As defined in the North Carolina Agency Purchasing Manual, information technology is electronic data processing goods and services, telecommunications goods and services, microprocessors, software, information processing, office systems, any services related to the foregoing, and consulting or other services for design or redesign of information technology supporting business processes.

## **PERFORMANCE AUDIT**

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

The audit objectives were to determine whether the Department of Administration, Division of Purchase and Contract (P&C) state term contract process effectively ensures (1) state agencies comply with state term contracts and (2) the state is maximizing savings from state term contracts.

The Office of the State Auditor initiated this audit to improve the effectiveness of state term contract management.

The audit scope included all requisitions processed by state agencies through the state's automated procurement system, NC E-Procurement, from July 1, 2008 through June 30, 2009. Purchase and Contract's Administrative Code defines an agency as all departments, institutions, boards, commissions, universities, and other units of the state. However, requisitions processed by state universities and community colleges were excluded from the audit scope because universities and community colleges have additional statutorily authorized conditions where the use of state term contracts is not required.<sup>3</sup> In addition, our review was limited to state term contracts administered by the Division of Purchase and Contract. We conducted fieldwork from May 15, 2010 through June 10, 2010.

To achieve our audit objectives we analyzed information provided by agencies in NC E-Procurement, observed operations, and reviewed contracts and documentation. We also interviewed P&C personnel, NC E-Procurement staff, and other applicable personnel.

Because of the test nature and other inherent limitations of an audit, together with limitations of any system of internal and management controls, this audit would not necessarily disclose all performance weaknesses or lack of compliance.

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.

We conducted this audit under the authority vested in the State Auditor of North Carolina by *North Carolina General Statute* 147.64.

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<sup>3</sup> As specified in *North Carolina General Statutes* [116-13](#) and [115D-58.14](#).

## FINDINGS AND RECOMMENDATIONS

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### STATE TERM CONTRACT PROCESSES DO NOT ENSURE STATE AGENCY COMPLIANCE OR MAXIMIZE SAVINGS

*North Carolina General Statute 143-49* establishes the Department of Administration (Department) as the State's central purchasing authority. Furthermore, *North Carolina General Statute 143-55* generally requires state agencies to purchase supplies, materials, and equipment from contracts established by the Department. The Division of Purchase and Contract (P&C) within the Department provides oversight of state term contracts. However, there are significant weaknesses in the state term contract process. Specifically, (1) the NC E-Procurement system is not used to ensure agency compliance with state term contracts; (2) P&C monitoring procedures do not efficiently and effectively detect widespread noncompliance with state term contracts, and (3) state term contracts are often awarded to multiple vendors, which prevents maximization of savings.

#### **NC E-Procurement System Not Used to Ensure Compliance**

Three conditions currently limit P&C's ability to use the NC E-Procurement system to enforce and monitor compliance with state term contracts.

First, vendor and price information is not always loaded timely into NC E-Procurement after state term contract execution. P&C is required to load vendor and product pricing information into E-Procurement upon execution of a state term contract; however, sometimes there are delays. For example, three state term contracts with start dates in December 2008 were still not in the NC E-Procurement system as of June 2010. Similarly, two state contracts with start dates in January 2009, and three other contracts with start dates in April, September, and December 2009 were not in the NC E-Procurement system as of June 2010.<sup>4</sup> A lack of timely vendor and price information in NC E-Procurement could result in unintended noncompliance because state agencies may not be able to determine if a commodity is covered under a state term contract.

Second, the NC E-Procurement system allows state agencies to purchase from non-state term contract vendors and not be timely detected by P&C. State purchasing rules require agencies to document reasons for not using a state term contract vendor. However, the documentation is maintained in the agency's files and is not captured by the NC E-Procurement system. As a result, noncompliant purchases and the reasons for noncompliance will not be identified by P&C unless and until P&C conducts an onsite review of the agency's purchases. Furthermore, the onsite reviews will not be timely enough to prevent or recapture loss savings from noncompliant purchases. Because state agencies are not required to document the reasons for noncompliant purchases in the NC E-Procurement system, agencies can circumvent the state term contract process and select other vendors. For example, a review of state term contracts for automotive filters and dry cell batteries<sup>5</sup> indicates that state agencies did not use the designated state term

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<sup>4</sup> State term contracts not timely loaded in the NC E-Procurement system included but were not limited to contracts for furniture, travel cards, rental vehicles, birth control items, and energy saving devices.

<sup>5</sup> State term contract 060C applies to automotive filters and state term contract 450A applies to dry cell batteries

## FINDINGS AND RECOMMENDATIONS

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contract vendor for 779 (48%) of requisitions for automotive filters identified under commodity code 060-42<sup>6</sup> and for 128 requisitions (24%) of the requisitions for purchases of dry cell batteries.

Noncompliance with state term contracts for purchases of applicable goods and services reduces the cost savings agencies realize from state term contracts. For example, if agencies had used the applicable state term contract when purchasing automotive filters, the State would have saved \$196,816 or 31% of total expenditures for these products in FY 08-09.<sup>7</sup> Full compliance with the state term contract for battery purchases would have resulted in \$19,120 in additional cost savings, or 24% of the total expenditures for these product purchases.

Third, P&C does not use existing functionality in NC E-Procurement to ensure that state agencies provide accurate and complete requisition information. As a result, information necessary to identify noncompliance is not always available. For example, a review of the 2,323 purchases subject to state term contract 207A, Remanufactured Toner Cartridges, identified the following:

- 599 requisitions where the commodity code and/or the state term contract were inaccurately identified;
- 211 requisitions with a missing supplier part number; and
- 21 requisitions where the reported unit of issue (example: each, dozen, pack) did not correlate with the unit of issue specified in the state term contract.

Inaccurate commodity code and product information make it difficult to identify purchases subject to state term contract requirements and identify instances of noncompliance. Also, inaccurate unit of issue data limits the ability to determine if agencies are utilizing negotiated prices for purchases of goods and services subject to state term contracts.

### **Monitoring Procedures Do Not Efficiently and Effectively Detect Noncompliance**

Considering the volume of purchases made through the E-Procurement system, P&C monitoring procedures are not efficient or effective for detecting widespread noncompliance with the state term contracting process.

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<sup>6</sup> Products identified in [Term Contract 060C](#) apply to commodity code 060-42. Requisitions with a reported net amount less than \$150 were excluded from the analysis because, as specified in the state term contract, agencies are not required to utilize the vendor stipulated in the contract when the purchase amount is less than \$150. We also excluded 36 requisitions that appeared to have a misreported commodity code or were not otherwise subject to state-term contract requirements.

<sup>7</sup> The estimated cost savings was calculated by first determining the average unit cost for requisitions reported under each commodity code that utilized the authorized vendor for the applicable state term contract. We then applied this average unit cost for vendor compliant requisitions to identified non-vendor compliant requisitions. The difference between the calculated amount and the actual expenditures associated with non-vendor compliant transactions produced our cost savings estimate. Due to lack of product information for non-vendor compliant requisitions, this methodology assumes that the composition of products among vendor compliant requisitions is representative of all purchases reported under the applicable commodity code.

## **FINDINGS AND RECOMMENDATIONS**

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P&C compliance reviews were not comprehensive enough to detect widespread noncompliance with state term contracts or to estimate the total rate of noncompliance throughout state government. State agencies processed about 340,761 requisitions with a value of over \$3.7 billion through the NC E-Procurement system during the 2009 fiscal year, but the primary method P&C uses to detect noncompliance with state term contracts is compliance reviews at individual agencies. These compliance reviews include reviewing a sample of requisitions to identify instances of noncompliance at an agency. P&C performed five reviews in fiscal year 2009 and nine reviews in fiscal year 2010. Nine of the 14 reviews were performed at community colleges, two were at universities, and four were at medical units under the Department of Health and Human Services (DHHS). None of the reviews were comprehensive compliance reviews of DHHS or other state agencies such as the Department of Transportation, Department of Public Instruction, or Administrative Office of the Courts.

Additionally, P&C does not capture and analyze the overall reasons for noncompliance with state term contracts. Gathering and analyzing this information could assist P&C in identifying special types of goods or services that are not currently covered under the state term contract but should be included in future contracts due to overall high purchase volume. This data could also assist in identifying agencies with unusually high noncompliance for a more focused analysis of agency procurement practices.

### **Multiple Vendor Awards Prevent Savings Maximization**

State term contracts are sometimes awarded to multiple vendors, and at different prices. When awards are not limited to the vendor offering the best value, potential savings from state term contracts will not be fully realized. Contracts with different prices among vendors for the same product limits achievement of expected cost savings from state term contracts because agencies may not choose the vendor with the lowest price. P&C does not have written criteria for determining the cost/benefit of using a single vendor or multiple vendors for a state term contract.

A review of selected state term contracts demonstrates the reduction in realized savings by the State from multiple vendor use. For example, state term contract 207A, Remanufactured Toner Cartridges, identified 24 products with multiple vendors and different prices. For many of these requisitions, agencies purchased from the higher priced vendor. Agencies could have saved \$12,500 if all of these product purchases were made from the lower priced vendor.

Also, purchases reported under this commodity code included 207 requisitions for new toner cartridges procured under state term contract 615A instead of remanufactured toner cartridges, as specified in state term contract 207A. The average unit price of these new toner cartridges was 425% (\$120.65 versus \$28.37) more than the negotiated state term contract price for comparable remanufactured toner cartridges. Consequently, agencies did not realize \$41,211 in potential cost savings, or 8% of the total expenditures subject to these state term contracts.

## FINDINGS AND RECOMMENDATIONS

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Another example of the adverse impact of multiple vendors awards are purchases made under commodity code 450-06, Dry Cell Batteries. Currently, these products can be purchased through two separate state term contracts, and at different prices.<sup>8</sup> As with purchases of toner cartridges, agencies frequently purchased from the vendor with the higher price. Specifically, 94 agency requisitions for these products utilized the higher priced vendor, resulting in \$1,204 of lost cost savings.

Awarding state term contracts to multiple vendors also limits the effectiveness of the process because vendors cannot reliably predict sales volume. This uncertainty limits vendors' ability to provide the lowest price because expected profits from a state term contract award cannot be reliably calculated.

**Recommendations:** To ensure compliance with state term contracts, P&C should load state term contract information into the NC E-Procurement system in a timely manner. P&C should also consider using system edits in NC E-Procurement. System edits can be used to require state agencies to consider a state term contract vendor and to electronically capture the reasons for any noncompliance. System edits can also ensure that accurate procurement data is collected from state agencies that can be used to evaluate cost savings realized from the use of state term contracts.

To ensure adequate monitoring of state term contracts, P&C should consider using NC E-Procurement functionality that allows agencies to electronically document reasons for not using the applicable state term contract. Ready access to documented reasons for noncompliance can improve monitoring of the state term contracting process. For example, information from this documentation can be used to identify goods and services appropriate for future state term contracts. Also, this information can be used to better allocate compliance monitoring resources to state agency procurement processes with indications of significant noncompliance or ineffective procurement processes.

P&C should establish and document criteria and a methodology for determining when to use a single vendor versus multiple vendors for a state term contract. While there may be legitimate reasons for using multiple vendors, such as efficiencies associated with vendor's geographical proximity, these reasons should be documented. Unless otherwise directed by the Legislature, use of multiple vendor awards should be limited to goods and services meeting these established criteria.

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<sup>8</sup> State term contracts [450A](#) and [615A](#) include dry cell batteries. State term contract 450A is specific to dry cell batteries, while state term contract 615A includes other general office products. Our analysis excluded requisitions with total net cost of less than \$25 because as specified in the state term contract, agencies are not required to utilize the designated vendor for these transactions.

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## North Carolina Department of Administration

Beverly Eaves Perdue, Governor

Moses Carey, Jr., Secretary

October 12, 2010

The Honorable Beth A. Wood  
State Auditor  
Office of the State Auditor  
20601 Mail Service Center  
Raleigh, NC 27699-0601

Dear Ms. Wood,

Thank you for sharing the results of the recent performance audit of the North Carolina Department of Administration's Division of Purchase and Contract. As you are aware, the Department of Administration was in the process of initiating efforts related to improving procurement in the State at the time this audit was underway, and the findings in the audit support the reasons we had initiated an RFP to undertake a review of all procurement activities. As such, we find ourselves in agreement with your recommendations, some of which we can initiate corrective action immediately, and some of which we will refine over the coming months.

Per your request, please find below our responses to your audit recommendations:

**AUDIT RECOMMENDATION #1:** To ensure compliance with state term contracts, P&C should load state term contract information into the NC E-Procurement system in a timely manner. P&C should also consider using system edits in NC E-Procurement. System edits can be used to require state agencies to consider a state term contract vendor and to electronically capture the reasons for any noncompliance. System edits can also ensure that accurate procurement data is collected from state agencies that can be used to evaluate cost savings realized from the use of state term contracts.

**NCDOA RESPONSE:** The Division of Purchase and Contract agrees with your recommendation that state term contract information should be loaded into the NC E-Procurement system in a timelier manner and our State Purchasing Director has directed the purchasers to have the outstanding ones entered into the system by the end of this month, and in the future to do so in a timely manner, and we will provide for better management oversight of this.

We also agree with your recommendation to devise ways to ensure better compliance with the use of established term contracts in order to save money. To accomplish this electronically prior to the purchase would require software enhancements or software replacement. The state is currently looking at software changes and will take your recommendations into consideration as we make those decisions. Our current software does have an optional comment box in which the requester should be including any comments needed to document reasons for contract deviations.

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Session Law 2010-194/Senate Bill 1213 addresses the need for additional training and more compliance reviews. Better training will enhance our users' awareness of term contracts and their use. We have begun meeting with the Office of State Personnel's Training Center Director and will be meeting with School of Government staff in the near future to develop programs to better meet training needs both for Division employees and state procurement staff.

**AUDIT RECOMMENDATION #2:** To ensure adequate monitoring of state term contracts, P&C should consider using NC E-Procurement functionality that allows agencies to electronically document reasons for not using the applicable state term contract. Ready access to documented reasons for noncompliance can improve monitoring of the state term contracting process. For example, information from this documentation can be used to identify goods and services appropriate for future state term contracts. Also, this information can be used to better allocate compliance monitoring resources to state agency procurement processes with indications of significant noncompliance or ineffective procurement processes.

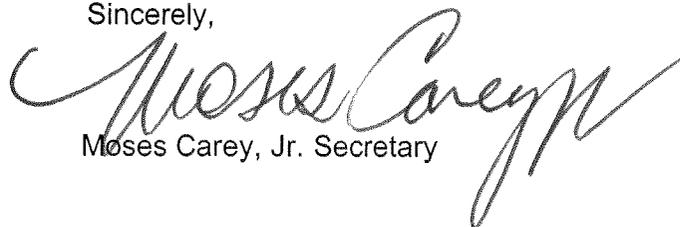
**NCDOA RESPONSE:** The Division of Purchase and Contract agrees with your recommendation for the need to implement an electronic functionality that would require the user to request prior approval from Purchase and Contract for any deviations to the term contract. To accomplish this electronically prior to the purchase would require software enhancements or software replacement. The state is currently looking at software changes and will take your recommendations into consideration. Our current software does have an optional comment box in which the requester should be including any comments needed to document reasons for contract deviations, and a memo that is in the process of being written for issuance statewide this month will include this directive.

**AUDIT RECOMMENDATION #3:** P&C should establish and document criteria and a methodology for determining when to use a single vendor versus multiple vendors for a state term contract. While there may be legitimate reasons for using multiple vendors, such as efficiencies associated with vendor's geographical proximity, these reasons should be documented. Unless otherwise directed by the Legislature, use of multiple vendor awards should be limited to goods and services meeting these established criteria.

**NCDOA RESPONSE:** The Division of Purchase and Contract agrees with your recommendation that we should establish and document criteria and methodology for determining whether to award a term contract to a single vendor versus multiple vendors. Multiple award contracts should be kept to a minimum and we will develop criteria for making these decisions and will train our purchasers on analyzing and complying with this policy.

The Department of Administration appreciates your efforts in helping our Division of Purchase and Contract to improve our performance and accomplish our primary task, which is to save the taxpayer money. If you have any further questions or need any clarification, please feel free to let me know.

Sincerely,



Moses Carey, Jr. Secretary

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## **ORDERING INFORMATION**

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