

Performance Audit 13-01: Office Supply Contracts

April 2013

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

April 19, 2013

To: Mayor Andy Berke
City Council Members

Subject: Office Supply Contracts (Audit #13-01)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our audit of office supply contracts. We found proper procedures were not followed in bidding and contracting for supplies, paper and ink cartridges and contract terms are not followed in pricing of office supplies. We also found the automated data (computer) systems have not been utilized to maximize efficiency and effectiveness of contract management.

In order to address the noted areas for improvement, we recommend criteria for evaluating bids be explicitly stated on the face of the bid specifications, a consistent method be used to develop bid specifications and evaluate bids. We identified improvements that are needed to increase monitoring of contract pricing. In addition, we recommended additional steps be taken prior to renewing blanket contracts. We recommended several changes to the *City Procurement Manual* and adherence to certain policies already in place, notably the policy to provide explanation when the lowest bidder is not selected.

We thank the management and staff of the Purchasing Division and Finance Department for their cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM
City Auditor

Attachment

cc: Travis McDonough, Chief of Staff
Andrew Kean, Chief Operating Officer
Dan Thornton, Interim Purchasing Manager
Daisy Madison, Chief Financial Officer
Audit Committee Members

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2013 Audit Agenda. The objectives of this audit were to determine if:

- Proper procedures were followed in bidding and contracting for Office supplies, paper and ink cartridges;
- Contract terms are being followed in pricing and delivery; and
- Automated data (computer) systems have been utilized to maximize efficiency and effectiveness of contract management.

BACKGROUND

The City uses blanket purchase orders to contract for common use items anticipated to have more than \$10,000 of purchases in a given year. Blanket purchase orders allow City agencies to order small or large quantities of items from the contracted vendor during a specified period at a discounted rate. Blanket purchase orders increase cost-effectiveness by ensuring small purchases are made at the best rate and increase the efficiency of purchases by having a single source for the items.

The City has three blanket purchase orders for office supplies. Contracts are for printer/copier paper, printer/copier ink toner cartridges and standard office supplies (staples, writing pads, etc.).

Financial Information

During the audit period (July, 2010 – December, 2012) office supply purchases under audit are listed below.

Exhibit 1: Office Supply Purchases, FY2011-FY2013

Contract	FY2011	FY2012	FY2013 Jul-Dec
Office Supplies	\$183,555	\$177,019	\$85,044
Toner Cartridges	152,501	220,169	137,491
Printer Paper	56,260	44,697	19,542
Total	\$392,316	\$441,885	\$242,077

FINDINGS AND RECOMMENDATIONS

Contract for toner cartridges was not awarded to the lowest bidder.

When the lowest bidder is not selected to win a bid, *The Internal Control and Compliance Manual for Tennessee Municipalities*, Title 5, Chapter 18, section 8, and the *City Procurement Instructional Manual*, section 2.05(7), require the reason be documented in writing and filed in the purchase order file. The reason must also be stated in the recommendation for Council approval.

A letter was located in the purchase order file for printer toner/cartridges recommending the contract be awarded to Unistar-Sparco, the low bidder, along with a letter on the same date recommending the contract be awarded to COS Business Products (COS). The purchase order file contained no documentation explaining the change in recommended bid winners, nor was the variance from policy (not awarding bid to low bidder) detailed in the recommendation to Council.

Per the Purchasing Manager, the change to the higher cost vendor was made at the direction of the Mayor's Office. The justification for the change was explained as the desire to keep the business local, obtain faster service, and that COS cleans each printer upon replacement of a toner cartridge. These criteria were not mentioned in the bid as factors to be considered in awarding the contract. Any criteria to be considered in determining the winner of a bid should be clearly stated in the bid solicitation documents.

Recommendation 1:

We recommend compliance to *The Internal Control and Compliance Manual for Tennessee Municipalities*, Title 5, Chapter 18, section 8, and the *City Procurement Instructional Manual*, section 2.05(7).

Auditee Response: *The Purchasing Department was instructed by upper management to award the contract to the local company.*

Recommendation 2:

We recommend all qualifying factors that will be used in the determination of a bid winner be clearly stated in the bid package.

Auditee Response: *We agree.*

Consistent, sound methods for developing bids and awarding contracts are needed.

While the *City Procurement Instructional Manual* offers Buyers a checklist to guide activity surrounding the bid (such as sending out the bid, sending insurance requirements, contacting minority suppliers), it does not provide guidance to staff in developing specifications or evaluating bids in order to determine bid winners. As a result, the most cost-effective products may not be selected. Our review of office supply contracts identified issues with methodologies used for bid specification development as well as bid evaluation.

Bid Specification Development

The standard office supply contract specifications required bidders submit prices for the 50 standard office supply items purchased in the highest quantity during the prior 12 month period. However, the preferred method would be to consider the top 50 items associated with highest expected cost. Failure to consider the total expected cost of the items included in the bid could result in the bid being awarded to a vendor who has the best price for high volume (but low priced) items rather than the lowest overall prices.

Exhibit 2 provides a comparison of methods for developing bid specifications. We used information in the bid specifications submitted by one vendor for the top 10 items by quantity and compared it with prices for the top 10 items selected by expected cost. We then determined the percent of all FY2012 expenditures (\$177k) that was represented by the bid specification resulting from the method.

As shown below, bid specification based on the top 10 items by expected cost would provide information on discounted rates for 8% of the 2012 purchases, while the top 10 items selected by quantity provides information on discounted rates for 2% of the 2012 purchases. Adopting a policy of developing bid specifications based on the items with highest expected costs would allow evaluation of the bids submitted to better reflect anticipated overall discounts on items the City purchases within a given year.

Exhibit 2: Comparison of Methods for Developing Contract Specifications

**Top 10 Items by Quantity
(Current Method)**

Description	Quantity	Expected Cost
5-Tab Notebook Dividers	800	\$472
Report Covers	550	495
Permanent Markers	484	189
Paper Clips	402	4
Small Clip Binders	402	56
Monthly Desk Pad	305	546
Jombo Gem Clip	389	58
Invisible Tape	219	129
Letter File Folders	210	628
5-Tab Notebook Dividers	210	82
Total Expected Costs		\$2,659

% of FY2012 Purchases
Represented in Bid
Specification 1.50%

**Top 10 Items by Expected Cost
(Preferred Method)**

Description	Quantity	Expected Cost
Record Book	46	\$2,075
Index Cards	20	1,960
Letter Folder	26	1,547
Tripod Easel	10	1,547
File Folder	272	1,435
Tape	117	1,399
Tape	94	1,288
Shredder	1	1,200
Tape	14	1,169
Compact Discs	45	1,125
Total Expected Costs		\$14,742

% of FY2012 Purchases
Represented in Bid
Specification 8.33%

Recommendation 3:

We recommend future bids be based upon items with the greatest total expenditures, not always the greatest quantity, when only a sample of items is used for evaluation. An example would be instead of high volume but low cost items (staples or paper clips), include more expensive but lower quantity items (surge protectors and batteries).

Alternatively, when bids are solicited for a single contract including a high number of differing items, the Purchasing Division might consider requests for the entire catalog with an overall stated discount. Evaluation of bids could then be based on a sample of items from the catalog (determined after bid opening).

Auditee Response: We agree.

Bid Evaluation

We examined bid award methodologies for the three office supply contracts and found a consistent method for determining bid winners was not used. While bidders were asked to submit unit pricing, as well as estimated total cost to the City, two methods used to award bid winners did not consider the effect of quantities expected. Three distinct methods were used to evaluate the bid submissions and determine a winner. The three methods observed are described below:

- *Estimated Total Cost*— This method used the estimated purchase quantity multiplied by the unit price for each product and compared the total price. It should be noted that each vendor submitting a bid is required to offer the estimated total cost for each item in the bid specifications.
- *Unit Cost*— This method summed the unit price of each item in the bid with no weight given to the expected quantity for each item.
- *Average Cost Plus*— This method used an average unit price of each item in the bid plus the average unit price of a randomly chosen sample of items being bid.

Standard business practice would be to consider the estimated total cost of the contract. Failure to weigh costs based on estimated quantities can skew the total expected cost and result in a contract being awarded to a company that was not the low bidder. For example, the standard office supplies contract was awarded using the *Unit Cost* approach. Below, we present results from the *Unit Cost* approach as compared to the results that would have occurred using the *Estimated Total Cost* approach (standard business practice).

Exhibit 3: Award Winners Resulting from Two Evaluation Methods

Bidder	Unit Cost Method	Estimated Total Cost Method
Office Depot	\$74.29	\$8,734.95
Chattanooga Office Supply	73.95	9,509.22
Price Differential	\$0.34	(\$774.27)
Winner	COS	Office Depot

Source: Auditor Analysis of Bid Specifications

As shown in the standard office supply scenario in Exhibit 3, awarding the contract to COS is likely to result in higher actual costs to the City. Using estimated quantities from the previous year, costs would be \$775 (or 8.14%) higher for the 50 items in the bid. In addition to higher costs, it is misleading to bidders when bid submissions are not evaluated in the manner solicited (estimated quantities with an extension of the per unit bid price). The use of erratic and differing evaluation methodologies can also result in an appearance of bid manipulation.

Auditee Response: We agree.

Recommendation 4:

We recommend minimum requirements be developed, and the *City Procurement Instructional Manual* revised, to describe the minimum detail to be included in a bid, along with the method to be used in determination of the bid winner. We also recommend the Manual be revised to require all bid solicitations to include the methodology to be used to evaluate the bids.

We recommend criteria be developed, and consistently followed, in determination of bid winners for purchases of like items. The criteria could include standardized templates specifying certain factors be considered in determining the winner of a bid (e.g. quantity multiplied by price, percentage discount on other items, time of delivery, services offered at no charge with purchases), and a weighting system developed to determine the bid winner. This process might consist of several templates, dependant on the type of product being purchased. We further recommend these steps be added to the purchasing checklist to track compliance with these additional steps.

Auditee Response: *Training of Buyers began April 4, 2013. All Buyers have been supplied copies of the portions of state law, The Internal Control and Compliance Manual for Tennessee Municipalities and City Code that pertain to the purchasing function. It has been stressed to the Buyers bid winners must be chosen in a structured, logical and defensible manner.*

Recommendation 5:

We further recommend training be given to the Buyers to provide working knowledge of the relevant portions of State law, *The Internal Control and Compliance Manual for Tennessee Municipalities* and City Code. We also recommend further training to help Buyers determine important elements of a bid (discounts on the entire catalog, free or inexpensive service add-ons, etc.) having the greatest effect related to the overall cost of a contract. We also recommend quality/supervisory review of Buyer activities.

Auditee Response: *We agree.*

Improvements are needed in monitoring contract compliance with pricing.

The standard office supply contract was awarded to Chattanooga Office Supply (COS) based on 50 items with static pricing for the course of the contract. A file was obtained from COS containing 2012 purchases. Pricing in that file was compared to prices on the purchase order. Of the items purchased, 91% were not priced at the agreed upon price, the differences per unit ranged in amount from \$0.20 to \$2.50. Overall, we found expenditures were 3% greater than the bid pricing.

The purchasing and accounts payable systems rely on matching information entered internally on purchase orders with other information such as receiving reports and invoices. Purchases handled within the automated system require a three way match to facilitate correct payment of an invoice. A three way match consists of comparing the invoice and receiving report to match quantity and item number and comparing invoice items and pricing to purchase order information. If the quantity, item and unit price match, the invoice is processed for payment.

However, most purchases of office supplies by the City are made using a departmental purchase card through the COS Business Products website. Items purchased using a purchase card are approved through the monthly departmental purchase card statement process. This procedure does not allow use of the automated controls inherent in an electronic system, such as price matching against the purchase order, as in a normally invoiced purchase.

We noted the following improvements are necessary to ensure optimal blanket contract prices are received:

- *Management should ensure all lines of the contract are entered into Oracle properly.* Blanket contracts may have many products with specified discounted prices in the bid. Each product corresponds with a line entered into Oracle by the purchasing agent when the contract becomes effective. There is a high risk of error in this process. For example, we found blanket purchase order #517932, for printer cartridges, was not entered into the purchase order system correctly. The bid for printer cartridges/toner included over 1,500 individual cartridges. Purchase order #517932 lists 594 items, excluding over 900 items in the bid, but not listed on the purchase order. Additionally, 24 prices listed in the blanket purchase order do not match the corresponding figure on the bid, including one \$200 higher than bid price.
- *Management should continually educate purchasing contacts within departments on available discounts.* We observed information regarding potential savings on office supplies was provided to departments only one time, when the contract was originally awarded, in mid-2010.
- *Management should spot check prices paid to contracted rates monthly for purchases made with purchasing cards.* Currently, no spot checking is performed for agreed upon price discounts at any point in the process, leaving open the possibility of the City overpaying for office supplies.
- *Management should seek to optimize economies of scale discounts within contracts, where appropriate.* Items available for purchase by City employees may be reduced to a few products of the most popular items of each type with a catalog containing those products supplied to users in order to limit purchases to only those products. Implementation of such a policy would reduce cost to the City. For example, we noted the office supply contract with COS Business Products provides a minimum 50% discount on a small catalog of items, “the Office Essentials Program”. A sample of these items showed the average actual discount to be 65.3% of list price. Per COS, this catalog contains one of each type of the products that make up 80% of typical office supply purchases, but not a great variety of brands. However, the full office supply catalog is supplied to departmental personnel to make purchases.

Recommendation 6:

We recommend purchase order #517932 be revised to include all items in the bid, and all pricing confirmed and changed as appropriate. We further recommend a methodology be developed to ensure pricing on new purchase orders is correct. One method would be to have a Purchasing Division employee double check all items/pricing prior to completion of the purchase order (a simple control total comparison of the bid versus the system).

Auditee Response: *We agree.*

Recommendation 7:

We recommend the Purchasing Division institute a policy to spot check prices charged on purchase cards for office supplies under contract each month. One method to accomplish this would be to obtain an electronic file of purchases for the previous month from the vendor containing item number, quantity, price per unit and total charge. This file could be electronically compared to the prices bid for static priced parts, as well as those to be purchased at a 50% discount by the City.

Auditee Response: *When office supply purchases were transferred to purchase cards, the process was implemented without full consideration of internal control implications, by both the Purchasing and Finance Departments. The recommendation to spot check invoicing was implemented while the audit was underway, following discussions with Internal Audit personnel. We are currently working with the vendor to develop a file structure to allow us to electronically check pricing.*

Recommendation 8:

We recommend the Purchasing Division send a memo to all departmental personnel responsible for ordering supplies twice annually as a reminder of available discounts on products currently under contract, as well as how to obtain the discounts. We also recommend actions be taken to ensure updated Office Essentials catalogs are delivered to users as they are published by the vendor.

Auditee Response: *A quarterly memo to all departments listing available discounts has recently been implemented.*

Recommendation 9:

We recommend when contracts are being developed for products with many similar items in the catalog, the items available for purchase by City employees be reduced to a few products of the most popular items of each type, and a catalog containing those products be supplied, limiting purchases to only those products. Implementation of such policies would reduce cost to the City.

Auditee Response: *We agree. Work is underway to develop an office supply catalog to reduce office supply expense to the City while supplying City Personnel with all needed supplies.*

Recommendation 10:

We recommend determination be made of the amounts overpaid to COS for office supplies since July 2010 and COS return that amount to the City.

Auditee Response: *We agree.*

Blanket purchase orders are automatically renewed.

The office supply contract awarded in 2010 has been renewed two times, in 2011 and 2012. Good business practice would require work be performed to ensure the contract provides ongoing benefit to the City. The renewals are based solely on the premise of lack of complaints about the service. The decision should be made considering if the static priced items are being purchased, pricing for the contracted items has decreased, etc.

Recommendation 11:

We recommend all blanket purchase orders be researched prior to renewal, ensuring the products under contract are currently being used and the contract continues to provide a greater financial benefit than may be provided by other vendors if rebid, with this determination documented in the purchase order file.

Auditee Response: *We agree.*

APPENDIX A: OBJECTIVES, SCOPE AND METHODOLOGY

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers office supply purchases from July 1, 2010 to December 31, 2012. Source documentation was obtained from vendors, as well as the Purchasing and Finance Divisions. Original records, as well as copies, were used as evidence and verified through physical examination.

All transactions during the audit period were tested for printer cartridges and copier/printer paper. Calendar year 2012 was sampled for office supplies.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in the City financial systems. The City's financial system was previously determined to be reliable and no additional work was necessary. Data received from vendors was sampled against City records to insure accuracy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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