

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL

191.4

OPERATIONS OF THE
DEPARTMENT OF GENERAL SERVICES
OFFICE OF PROCUREMENT

FEBRUARY 1975

TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

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February 24, 1975

Honorable Bob Wilson
Chairman, and Members of the
Joint Legislative Audit Committee
Room 4126, State Capitol
Sacramento, California 95814

Dear Mr. Chairman and Members:

Transmitted herewith is our report on the operations of the Office of Procurement of the Department of General Services.

The Office of Procurement, which is generally responsible for making each state purchase of supplies and equipment in excess of \$25, was established for the purpose of centralized state purchasing in order to achieve standardization, eliminate duplication of effort and acquire the lower prices achievable through quantity purchases.

During fiscal year 1973-74, the office processed over \$194 million worth of purchases, and its overall performance was generally acceptable. The office, however, has not fully accomplished its purposes. As a result, state agencies are incurring an undetermined amount of additional costs.

The office's costs for staff, copying and other expenses incurred in the processing of purchases of \$200 or less for individual state agencies exceed the monetary benefits realized from such centralized purchases. Moreover, the office's efforts in processing such purchases are essentially paper shuffling. We recommend legislation be enacted granting state agencies the authority to make their own purchases in amounts of \$200 or less, rather than the current \$25 or less.

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The process of competitively bidding purchases with restrictive specifications is an ineffective use of the resources of the office. We recommend that the office reject agency specifications which restrict a product to a particular brand or model when other available brands or models would essentially provide the same product. As a result of our audit inquiries, the office has already eliminated restrictive specifications for vans saving an estimated \$14,000 to \$21,000 annually.

Vendors on statewide contracts are the only parties who are aware of the total volume of purchases on those contracts. This fact presents an opportunity for unfair advantage to such vendors, with regard to other competitive vendors, in the renewal of the contract and places the state at a disadvantage to the vendor on prices and quantities under the contract. We recommend that a procedure be established utilizing the computer system in the Controller's Office to determine the amount of payments made to each vendor and the volume of state agency purchases from specific statewide contracts.

As a result of a \$64,000 budget cut, the office was forced to terminate a highly profitable Acquisition Analysis Unit which was responsible for performing lease-purchase analysis on designated equipment requests of state agencies. This unit had achieved a reduction of \$650,000 in state expenditures during its first four months of operations. We recommend the reinstatement of this unit.

Due to a lack of adequate management information data necessary to consolidate the purchasing needs of all state agencies, we estimate that \$604,000 of electronic calculators purchased in 1973-74 were individual purchases of less than \$1,000, and therefore were not subjected to competitive bidding.

The Office of Procurement has not developed adequate commodity descriptions (it has 894 descriptions to accommodate approximately 50,000 commodities), has not monitored vendor response to bid invitations, resulting in 1/2 million invitations to bid being sent in a ten-month period to vendors who did not respond, and has not accumulated statistics to determine what specific commodities are being purchased by state agencies. We recommend that the office expand its commodity classification system, monitor vendor response to bid invitations and remove nonresponsive vendors, and accumulate statistical data relative to purchases of specific commodities by state agencies.

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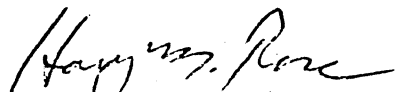
The Central Stores Inventory Management System, (CSIMS), which the Office of Procurement has spent \$651,000 to develop and operate as of June 30, 1974, is ineffective and unreliable. As a result, Central Stores inventory valuations are inaccurate, inventory management information is inadequate and unreliable, and the service provided by Central Stores to state agencies deteriorated during fiscal year 1973-74.

As an example of the unreliability of CSIMS, in July 1974, the CSIMS inventory status report listed 412 commodities with minus units on hand amounting to a minus inventory valuation of over \$61,000. This is a physical impossibility.

We have made a series of recommendations to improve CSIMS.

While the vast majority of state agencies which we surveyed were highly complementary of the Office of Procurement, we conclude that the implementation of our recommendations will result in increased efficiencies and economies.

Respectfully submitted,



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INTRODUCTION

In response to a legislative request, we have reviewed the operations of the Office of Procurement of the Department of General Services. The Office of Procurement is responsible for each state purchase of supplies and equipment in excess of \$25, with some statutory exceptions.

The office consists of three distinct operating units: Direct Purchasing, Warehouse-Resale, and Traffic Management.

The Direct Purchasing Unit is responsible for processing requisitions of state and local agencies, issuing annual term contracts based upon anticipated statewide usage, assuring firm prices and guaranteed sources of supply for one-year periods, providing direction and review of purchasing methods and techniques, developing statewide purchasing standards, coordinating and consolidating statewide purchasing programs, testing purchased products for compliance with purchasing standards, and conducting training programs for state agency personnel.

The Warehouse-Resale Unit consists of three sub-units: Central Stores, Documents and Publications, and Property Reutilization. The Central Store's sub-unit is responsible for buying operating supplies in large quantities at discounted prices for subsequent resale to state agencies. The Documents and Publications sub-unit is responsible for the sale of state publications and the distribution of publications to libraries. The Property Reutilization sub-unit is responsible for reviewing equipment disposed of by various state

agencies and selectively obtaining and reselling such used equipment to other state agencies.

The Traffic Management Unit is responsible for servicing and reviewing state shipping and freight receipt practices.

During fiscal year 1973-74, the Office of Procurement processed \$183,688,548 worth of purchases of which \$117,039,279 represents 50,149 individual purchase orders awarded by the office and \$66,649,269 represents 354 contracts issued by the office. In addition, the Warehouse-Resale element processed 417,318 Central Stores order lines of \$10,330,510, sold \$945,104 worth of publications, and resold approximately \$20,000 worth of equipment to state agencies. Traffic Management audited 15,337 freight bills and processed 1,802 requests for Traffic Management assistance.

It should be noted, however, that this report deals with deficiencies within the Office of Procurement that existed during the period of our audit, which essentially was concluded in September 1974. The Office of Procurement is also aware of many of the problems mentioned in our report and has formulated a comprehensive program which is intended to deal with many of these deficiencies, called SLAMM, which is the acronym for State Logistics and Materials Management.

SLAMM is a 12-phased program which will require 41 months to be fully implemented assuming the necessary funding is provided. Thus far, funding for the first four phases has been tentatively provided through fiscal year 1975-76.

Under the operating circumstances which exist, the Office of Procurement is generally meeting its program objectives. The vast majority of state agencies we surveyed were highly complimentary of the state procurement chief and his staff. However, we have concluded that implementation of the recommendations in this report would enable the Office of Procurement to administer its programs in a more efficient and economical manner.

FINDINGS

THE OFFICE OF PROCUREMENT HAS NOT FULLY ACCOMPLISHED THE PURPOSES FOR CENTRALIZED PURCHASES WHICH ARE THE STANDARDIZATION OF PURCHASES, THE ELIMINATION OF DUPLICATE EFFORT IN PURCHASING AND LOWER PRICES THROUGH QUANTITY PURCHASES. AS A RESULT, AN UNDETERMINED AMOUNT OF ADDITIONAL COSTS ARE INCURRED BY STATE AGENCIES.

The goals of the Office of Procurement, as stated in Sections 3501 and 3502 of the State Administrative Manual (SAM) are to centralize state purchasing in the Office of Procurement to "achieve standardization, elimination of duplication of effort, and lower prices as the result of volume buying".

Our review of the Office of Procurement disclosed the office is not fully accomplishing the purposes for centralized state purchases because:

- The office's costs of processing purchases of \$200 or less for individual state agencies exceed the monetary benefits realized from such centralized purchases
- Unduly restrictive specifications are permitted
- The volume of purchases on statewide contracts is not adequately monitored
- Lease-purchase analysis of equipment is not always effected
- The office does not have necessary management information

Purchases of \$200 or Less

Individual state agencies can effect purchases of \$25 or less without going through the Office of Procurement. Conversely, purchases of over \$25 must be made through the Office of Procurement on a centralized basis.

In actual practice, the office processes state agency purchases on an individual purchase order by purchase order basis, instead of on a coordinated and consolidated basis. In many cases this type of function is strictly clerical in nature and does not result in any significant monetary benefit to the individual state agencies, in the case of purchases for less than \$1,000, and particularly for purchases of \$200 or less.

Between February 1, 1974 and November 30, 1974, the Office of Procurement issued 37,438 purchase orders of which 23,709, or 63 percent, were for individual purchases of less than \$1,000. Available documentation indicates that these purchases represent seven percent of the dollar value of the purchase orders issued by the office during that period.

The Office of Procurement uses a procedure for processing purchase orders for less than \$1,000 called Express Line.

Basically, the Express Line functions this way: The state agency wishing to make a purchase prepares a purchase estimate which, among other things, describes the commodity to be purchased (often times very specifically)

and indicates the vendor from whom the agency would prefer to purchase the commodity. The Express Line buyers determine which vendors should be contacted, which are usually the same vendors referenced by the state agency, price quotations are obtained from the vendors contacted, and a vendor is selected.

We estimate that since the inception of the Express Line on January 7, 1974, the average processing time for purchase orders for less than \$1,000 has decreased from 32 calendar days to 12 calendar days, a significant improvement.

Notwithstanding the fact Express Line has improved service, the fact remains that the function of the Office of Procurement for purchases of less than \$1,000 is essentially paper shuffling, particularly for purchases of \$200 or less.

Table 1 summarizes the results of our statistical sampling of Express Line purchases as to the percentage of purchases awarded by Express Line buyers to the vendor recommended by the agency that originally prepared the purchase estimate, the percentage of purchases awarded by Express Line buyers as the result of lower prices being obtained from someone other than a vendor recommended by the agency originally preparing the purchase estimate, and the average savings, i.e. reduction in expenditures per purchase order resulting from lower prices achieved by the Express Line buyers.

Table 1

	<u>Purchases Not Exceeding \$200</u>	<u>Purchases More Than \$200 But Less Than \$1,000</u>	<u>Total</u>
Percentage of purchases state agencies recommend a vendor	99%	99%	99%
Percentage of purchases awarded by Express Line buyers to the vendor recommended by the agency that submitted the purchase estimate*	87%	81%	84%
Percentage of purchases Express Line generated savings to agencies by obtaining a lower price from a vendor not recommended by the agency that submitted the purchase estimate	8%	17%	13%
Average savings generated by the Express Line per purchase order processed	\$1.49	\$7.46	\$4.36

*Purchases of less than \$1,000 do not have to be competitively bid.

We estimate that approximately 52 percent of the Express Line volume is for individual state agency purchases of \$200 or less, which represents only 20 percent of the Express Line dollar volume. Thus, in our judgment, over one-half of the Express Line manpower is devoted to processing purchases, for the most part, exactly as prepared by the agency that originally submitted the purchase estimate. This function is essentially paper shuffling and any cost savings generated from centralized purchases do not begin to cover the additional costs incurred to process the purchase through the Express Line.

About 16 percent of the Office of Procurement staff time, exclusive of administration, quality control, specifications, Central Stores, and Traffic Management, or \$120,000 annually, is devoted to purchases of \$200 or less. In addition, the office incurs other costs when processing purchase orders of \$200 or less, such as paper, copying, telephone, mailing, and storage costs. These additional costs can be substantial; for example, during 1974 the number of purchase orders of \$200 or less approached 15,000. The Office of Procurement usually makes 11 copies of each purchase order, which means copy costs alone for purchases of \$200 or less are approximately \$10,000 per year which negates approximately half of the cost savings generated by the Express Line when processing purchases of \$200 or less.

In our judgment, the Office of Procurement would generate more savings for purchases of more than \$200 but less than \$1,000 if more time could be devoted to these purchases.

Currently, there are six Express Line buyers handling approximately 2,400 separate purchases per month. At that volume, each buyer can devote only about 24 minutes to each purchase order. Under such time constraints, Express Line buyers are contacting only one vendor 79 percent of the time before awarding a purchase order.

CONCLUSION

The function of the Office of Procurement regarding purchases of \$200 or less is essentially paper shuffling, which costs more in staff time and copying costs than is realized from the centralizing of such purchases in the Office of Procurement.

RECOMMENDATION

We recommend that legislation be enacted to raise the current monetary limitation of \$25 as provided in Section 14792 of the Government Code to \$200 in order to enable individual state agencies, in lieu of the Office of Procurement, to effect purchases of up to \$200.

SAVINGS AND BENEFITS

Implementation of this recommendation will:

- Reduce the Express Line volume by 52 percent, thus either reducing Office of Procurement staffing requirements by \$120,000 or permitting the office to apply that manpower toward activities which are potentially of the greatest statewide benefit
- Generate an undeterminable amount of cost savings as a result of reduced staff, paper, copying, telephone, mailing and storage costs, which exceed in the aggregate the savings realized by obtaining lower prices on purchases of \$200 or less.

Restrictive Specifications

Section 14807 of the Government Code requires competitive bidding in that all contracts and purchases of supplies in an amount of \$1,000 or more shall be made or entered into with the lowest responsible bidder meeting specifications, except in cases when the agency and the Office of Procurement agree that an article of a specific brand or trade name is the only article which will properly meet the needs of the agency, or in cases where the Board of Control has made such determination. Section 14809 of the Government Code requires that when a purchase of supplies or equipment in excess of \$1,000 is made without competitive bidding, the office shall report to the Board of Control the fact of such purchase together with a written statement of the facts requiring the purchase of the supplies or equipment without competitive bidding.

The procedure of not bidding purchases in excess of \$1,000 and then reporting such purchase to the Board of Control is frequently used by the Office of Procurement. For example, during calendar year 1973, the Office of Procurement reported to the Board of Control that there were 3,781 contracts and purchases of supplies and equipment in excess of \$1,000 that were not competitively bid. These purchases amounted to \$25,440,295 and were justified by the office as follows:

- To match and intermember with existing equipment \$2,434,669
- Emergency purchase 6,425,303
- Sole known source 5,376,806

- Only known article meeting agency specifications	\$ 6,514,360
- Noncompetitive article	2,085,401
- Special article	210,005
- Only one quote received on bid	225,930
- No responsive bids received	<u>2,167,821</u>
Total	<u>\$25,440,295</u>

Notwithstanding statutory authority to procure specific articles or brand names when it is agreed that it is the only article which will meet the agencies' needs, state agencies frequently submit product specifications to the Office of Procurement for bidding purposes that effectively restrict bidding to a limited number of vendors, thus precluding true competitive bidding. As a result, the Office of Procurement wastes time and resources going through the formality of competitively bidding purchases with restrictive specifications which either should not be bid at all or should be bid competitively without restrictive specifications.

Generally, state agencies prepare their own product specifications and forward them to the Office of Procurement via purchase estimates which are reviewed by buyers in the Office of Procurement and incorporated into bid invitations which are eventually sent to vendors for competitive bidding.

During our review of Office of Procurement purchases in excess of \$1,000 which were competitively bid, we noted several instances of product specifications that were restrictive. Some specifications used actual brand or model names, thus restricting bidding to only those vendors that supply

those brands or models. Other specifications were practically word for word reproductions of language from specific product brochures or other promotional material.

One of the primary reasons specifications prepared by agencies are restrictive is that agencies frequently prepare specifications with the intention of purchasing one particular brand or model, despite the fact that other available brands or models would provide the agency with essentially the same product. In a survey of 59 agencies conducted by the Office of the Auditor General, 95 percent responded that they either often or occasionally (64 and 31 percent respectively) rely upon product brochures or existing equipment when preparing product specifications for submission to the Office of Procurement.

For example, during the course of our audit, we noted that the Office of Procurement was buying vans for disabled persons for the Department of Rehabilitation at higher prices than the statewide contract price for vans, because the department's specifications always specified a particular model van and therefore exceeded the specifications contained in the current statewide contract for vans. The Department of Rehabilitation always gave such a short delivery requirement, the office was unable to use the statewide contract. The use of the restrictive specifications, because of the short delivery schedule, resulted in additional costs of nearly \$700 per van on the average. As a result of our inquiries, the Office of Procurement informed the Department of Rehabilitation that in the future the office intended to utilize the statewide contract when purchasing vans for the department, regardless of any delivery dates set by the Department of Rehabilitation. Using the statewide contract will save the Department of Rehabilitation between \$14,000 and \$21,000 per year.

The process of competitively bidding purchases with restrictive specifications only serves to add time to the purchase cycle. For example, we calculate the average time for a competitively bid purchase to be processed through the Office of Procurement is 43 calendar days* of which 19 days represent the time between the mailing out of bid invitations and the awarding of the purchase order.

CONCLUSION

The process of competitively bidding purchases with restrictive specifications represents an ineffective use of Office of Procurement resources and results in merely delaying the procurement process an average of 19 days. Further, the use of restrictive specifications precludes the procurement of other available items essentially providing the same product.

RECOMMENDATIONS

We recommend the Office of Procurement reject agency specifications which restrict a product to a particular brand or model when other available brands or models would essentially provide the same product.

* We estimate that for 27 percent of the competitively bid purchases during the first four months of 1974, the Office of Procurement did not issue a call for bids within 30 days after receiving requisitions as required by Section 14799 of the Government Code.

We further recommend that if a bona fide need exists for a product which would be the subject of restrictive specifications that such product be purchased without going through the formality of competitive bidding.

SAVINGS AND BENEFITS

Implementation of these recommendations will result in:

- State agencies acquiring specific brands or models, when warranted, in the most expeditious manner
- The avoidance of the unnecessary use of Office of Procurement time and resources on bidding restrictive product specifications
- State agencies paying lower prices when competitive bidding is appropriate.

Volume of Contracts Is Not Adequately Monitored

In addition to its other duties, the Office of Procurement is also responsible for awarding statewide contracts. State agencies can purchase items directly from the vendor awarded the statewide contract without going through the Office of Procurement by using subpurchase orders.

Currently, the Office of Procurement does not independently develop the volume or dollar amount of state agency purchases from statewide contracts. Instead, the office relies upon the vendor awarded the specific statewide contract to provide such information by filing every three months with the Office of Procurement, a recap of total quantities and dollars sold per contract item and the total dollar amount purchased from the contract.

A large majority of contract vendors are not filing all of the required quarterly reports with the Office of Procurement. In fact, approximately 82 percent of contract vendors do not file the required final quarterly report.

The inability of the Office of Procurement to independently determine state agency purchases from statewide contracts can create serious problems for the following reasons:

- Most state contracts are for a specified amount plus and minus 20 percent. If during the contract year state agency purchases exceed 120 percent of the contract amount, pursuant to the terms of the contract, the current contract expires and a new contract must be rebid. On the other hand, if a

contract vendor wishes to discontinue supplying state agencies at the contract price because of increased costs, the vendor can assert, pursuant to the terms of the contract, that 80 percent of the contract amount has been purchased by state agencies and refuse to perform under the contract terms. In either case, the Office of Procurement has no way of independently determining when a contract should be rebid or when a contractor has fulfilled his contractual obligation to the state.

- Contract vendors may have an incentive to distort contract volume information relative to contract purchases in order to gain a competitive edge over other vendors when a new contract is rebid. Such an advantage can be costly to the state if the contract vendor charges the state a higher unit cost than would otherwise be charged if the true contract volume was known to all potential competitors.

In addition, the requirement that the contract vendor provide the record keeping for the Office of Procurement prevents some otherwise qualified vendors from bidding on contracts because they are not equipped to develop such information and results in inflated bid prices on contracts because the cost of keeping track of state purchases is passed on to the state as part of the bid price.

The Office of Procurement previously requested state agencies to forward copies of subpurchase orders in order to accumulate contract purchase volumes. This method proved to be ineffective, as many state agencies did not comply, and impractical because of the large quantity of subpurchase orders. As a result, the current practice of vendor reporting was implemented.

Information on amounts for specific contracts can be accumulated in the State Controller's Office because warrants are issued to contract vendors by the Controller's Office, thus providing a centralized location for determining contract volumes. Personnel in the Controller's Office informed staff from the Auditor General's Office that, if state agencies indicated contract numbers in addition to vendor names on claim schedules submitted to the Controller's Office for payment, a computer printout of payments made by vendor and contract number could be produced once a month. Such a listing could be used by the Office of Procurement to determine state agency purchases from statewide contracts.

CONCLUSION

Because of noncompliance, reliance on vendors to provide contract purchase information is ineffective and potentially costly to the state. It is essential that the state devise a practical method to independently determine state agency purchases from statewide contracts.

RECOMMENDATIONS

We recommend that:

- The State Administrative Manual be amended to require state agencies to indicate contract numbers in addition to vendor names on claim schedules submitted to the Controller's Office for payment
- The Controller's Office produce a computer printout once a month of payments made by vendor and contract number
- The Office of Procurement use such printouts to determine the volume of state agency purchases from specific statewide contracts.

BENEFITS

Implementation of these recommendations will result in an independent determination by the Office of Procurement of the volume of contract purchases thus eliminating any competitive advantage accruing to current contract vendors when the current contract expires and a new contract is rebid.

Equipment Leases

During 1973, state agencies made 80 separate purchases of equipment of \$1,000 or more amounting to \$1,006,307 through the Office of Procurement that were not competitively bid because the equipment was leased by the agency prior to its being purchased. In addition to the purchase price, the lease payments for this equipment amounted to \$1,633,064 for a total cost of \$2,639,371. We estimate that had this equipment been purchased outright and not leased prior to being purchased, the state would have saved \$778,970, or nearly 30 percent.

A thorough review of the 80 purchases of previously leased equipment revealed that in several instances agencies leased the equipment for only a short time before purchasing the equipment.

Beginning August 1, 1974, the Office of Procurement established a new Acquisition Analysis Unit which was responsible for performing lease/purchase analysis on designated equipment requests, and reviewing equipment requirements to determine the most economic method of equipment acquisition, i.e. lease or purchase.

During its first four months of operation, the Acquisition Analysis Unit generated an estimated \$650,000 of reduced expenditures by state agencies through the use of lease/purchase analysis.

On October 25, 1974, the Office of Procurement was denied a \$64,000 budget augmentation to fund the Acquisition Analysis Unit through the remainder of the 1974-75 fiscal year and the unit was eliminated effective December 1, 1974. As a result, the Office of Procurement is once again not controlling or reviewing the equipment lease/purchase activities of state agencies.

CONCLUSION

We conclude that an analysis as to whether equipment should be leased or purchased for state agencies by the Office of Procurement is a necessary procurement practice for effective and economical management of state purchases.

RECOMMENDATION

We recommend that funding be provided for the Office of Procurement to reestablish the Acquisition Analysis Unit to perform lease/purchase analysis of equipment needed by state agencies.

SAVINGS AND BENEFITS

Implementation of this recommendation will result in state agencies acquiring equipment in the most economical manner and will therefore result in an undetermined amount of reduced expenditures for state equipment.

Lack of Management Information

The Office of Procurement has not developed adequate management information or commodity descriptions regarding commodities being purchased by state agencies. As a result, it is not possible for the Office of Procurement to plan, coordinate and consolidate state purchasing, all of which is necessary to attain maximum efficiency and economy in state purchasing and unnecessary copying, mailing, and processing costs are incurred because of excessive mailing of bid invitations.

Currently, the Office of Procurement uses commodity descriptions that are too general. For example, the Office of Procurement classifies every commodity it purchases with one of only 894 general commodity titles, such as powered hand tools, electric computers, hospital X-ray equipment, hospital supplies, household furniture, EDP software, and office devices and accessories. According to Office of Procurement personnel these 894 general commodity titles have to accommodate the 50,000 or so different commodities the office is called upon to purchase.

The management information presently being developed by the Office of Procurement is even more generalized than these 894 commodity descriptions. The only accumulation of statistical data relative to commodities produced by the Office of Procurement shows purchases by only 87 major commodity groups such as furniture, stationery and office supplies, and office machines and special equipment. Currently, the only means available to determine how much of a specific commodity was purchased through the Office of

Procurement is to examine copies of purchase orders maintained by the office. This procedure is time consuming, inefficient and unreliable.

Because of the inadequate management information presently being developed by the Office of Procurement, it is not possible for the office to coordinate and consolidate state purchases in order to achieve maximum efficiency and economy. Instead, purchases for repetitively purchased commodities are, for the most part, processed as a single transaction on a day-to-day basis by the Office of Procurement.

Annually, the Office of Procurement notifies all state agencies of its program of scheduled purchases for a limited number (27 for 1974-75) of commodities. The stated goal of this program is to process agency requirements rapidly and, where possible, to consolidate the needs of several departments for like products into larger purchases to reduce unit costs through quantity discounts. However, the scope of this program is too narrow to be effective and participation by state agencies is strictly on a voluntary basis.

For example, electronic calculators is one of the 27 commodities listed by the Office of Procurement for both fiscal years 1973-74 and 1974-75. However, notwithstanding the attempt by the Office of Procurement to consolidate electronic calculators purchases, we estimate that during fiscal year 1973-74, the Office of Procurement issued approximately 1,000 separate purchase orders for electronic calculators. These purchases amounted to nearly \$1 million. We estimate that on the average, each purchase order for electronic calculators issued by the office during 1973-74 was for only three calculators, in spite of the office's attempt to consolidate such purchases. In addition, we estimate that \$604,000

of these electronic calculator purchases were not subjected to competitive bidding prior to being awarded since the purchase order was less than \$1,000.

Such repetitive individual purchases by the Office of Procurement are uneconomical because potential reduced expenditures from consolidating agency purchases are lost.

As an example of the potential economies available to the state through consolidation of purchases, we noted the purchase of 1,854 dictating and transcription units for several state agencies. By consolidating these units into one purchase, the Office of Procurement was able to get a quantity discount of 50 percent, or nearly \$370,000. This particular consolidation was not originally contemplated as such by the Office of Procurement. In fact, it represents 11 separate bid invitations that were subsequently canceled by the office for technical reasons prior to being combined into one purchase.

The absence of adequate management information is apparent in another area -- that of excessive bid invitations mailed by the Office of Procurement.

We estimate that vendors do not respond to approximately 78 percent of the bid invitations mailed by the Office of Procurement. We also estimate that on the average, the office mails bid invitations to 25 vendors for every competitively bid purchase and that two bid invitations, which are frequently several pages in length, are mailed to each vendor. During the period February through November 1974, the Office of Procurement competitively bid nearly 14,000 purchases which means that the Office of Procurement mailed more than

one half million bid invitations to nonresponsive vendors during that ten-month period. These excessive bid invitations are costly in terms of processing, copying, and mailing costs. For example, mailing and postage expenses and reproduction expenses incurred by the Office of Procurement during fiscal year 1973-74 totaled nearly \$140,000 and \$63,000, respectively.

There are two reasons for the high incidence of nonresponse to bid invitations; they are:

- The commodity listing of qualified bidders is too general. As a result, a vendor who is interested only in selling hammers, for example, would receive a bid invitation for every purchase of hand tools in excess of \$1,000.
- The office is not monitoring vendor responses to bid invitations. The office has the authority to remove any vendor from the qualified vendor list who fails to respond to three consecutive bids but has not exercised this authority in recent years.

CONCLUSION

It is essential that the Office of Procurement develop adequate commodity descriptions, monitor vendor response to bid invitations, and accumulate statistics and information relative to what specific commodities are being purchased by state agencies. These steps will facilitate an efficient, coordinated statewide purchasing program which is necessary to attain maximum efficiency and economy in state purchasing.

RECOMMENDATIONS

We recommend that the Office of Procurement:

- Expand its commodity classification system
- Monitor vendor response to bid invitations and remove nonresponsive vendors from the prequalified bidder list
- Accumulate statistical data relative to purchases of specific commodities by state agencies.

SAVINGS AND BENEFITS

Implementation of these recommendations will result in the development of a management information system for state purchasing, which will facilitate the planning, coordinating, and consolidation of state purchasing to achieve maximum efficiency and economy in state purchasing and significantly reduce mailing and reproduction expenses incurred by the Office of Procurement. Further, increased consolidation of purchases will result in an undetermined amount of reduced state expenditures from quantity discounts.

THE CENTRAL STORES INVENTORY MANAGEMENT SYSTEM, (CSIMS), WHICH THE OFFICE OF PROCUREMENT HAS SPENT \$651,000 TO DEVELOP AND OPERATE AS OF JUNE 30, 1974, IS INEFFECTIVE AND UNRELIABLE. AS A RESULT, CENTRAL STORES INVENTORY VALUATIONS ARE INACCURATE, INVENTORY MANAGEMENT INFORMATION IS INADEQUATE AND UNRELIABLE, AND THE SERVICE PROVIDED BY CENTRAL STORES TO STATE AGENCIES DETERIORATED DURING FISCAL YEAR 1973-74.

The Central Stores' operation is essentially a warehousing function performed by the state. That is, items commonly required by state agencies are purchased in bulk, for subsequent resale to state agencies, rather than having either the state agencies or the Office of Procurement effect individual purchases on the open market. As a warehousing system, control over inventory is essential to efficient and economical operation.

As of June 30, 1974, the Office of Procurement had spent \$651,000 to develop and operate a computerized inventory system for the Central Stores' operation of the Office of Procurement called CSIMS, which is the acronym for Central Stores Inventory Management System. The main purposes of the system are to (1) maintain an accurate book inventory; (2) maintain and process the necessary data to provide accurate fiscal and inventory control reports; and (3) maintain forecasting parameters which are used for predicting future sales.

Our review of CSIMS has revealed, however, that the system has failed to accomplish any of its stated objectives and as a result Central Stores' inventory valuations are inaccurate, inventory management information is inadequate and unreliable, and the service provided by Central Stores to state agencies deteriorated during fiscal year 1973-74.

Inventory Valuations are Inaccurate

The primary problem regarding the accuracy of the book inventory produced by CSIMS is the absence of adequate internal controls over the system.

Inherent in any good system of internal control is the concept of separation of responsibilities and duties which provides for a system of checks and balances. This concept is totally lacking in the current CSIMS.

Under the present structure, the custodial function relative to the inventory and the record keeping responsibilities are not segregated.

On June 30, 1974, the Department of Finance issued a letter to the Director of General Services disclaiming any opinion regarding the accuracy of the value of Central Stores' inventories.

The letter states in part:

"...Our examination consisted of a review of financial statements for the fiscal years ended June 30, 1972 and June 30, 1973. It also included a review of internal control and such other procedures as we considered necessary in the circumstances.

"The system used to account inventory of the Central Stores operation does not provide accurate and supportable data for input to the fiscal accounting system. Because of this, we make no attestation as to the value of the inventory as shown in the Post-Closing Trial Balance..."

In addition to organizational problems within Central Stores, CSIMS has never been able to properly execute even the most basic perpetual inventory operation, namely, beginning inventory plus stock receipts less stock sales equals ending inventory.

There are at least three known causes of this deficiency, all the result of computer system programming errors. The result of these errors is that the CSIMS book inventory is always incorrect, and yet the books of account, which are maintained by the department's Support Accounting Section, are adjusted to agree with the incorrect figure.

We estimate that as of June 30, 1974, the CSIMS book inventory was overstated at least \$297,478, which represents only three months' activity following adjustment of the book inventory to agree with the physical inventory as of March 31, 1974.

The Supply Operations Manager for Central Stores stated that CSIMS was never intended or designed to be an accounting system. This statement directly contradicts the currently stated first objective of CSIMS. In addition, the Support Accounting Section, which has overall accounting responsibility for the Department of General Services, relies on CSIMS output for accurate accounting information which ultimately is reflected on financial statements prepared by them.

Inventory Management Information
Is Inadequate and Unreliable

One of the primary inventory control reports produced by CSIMS is an inventory status report which lists each commodity by location, the number of units on hand, the selling price, inventory unit value, and inventory value on hand at both selling and valuation prices.

As an example of the inaccurate fiscal and inventory control reports currently being generated by CSIMS, it is not unusual for the CSIMS inventory status to show minus units in inventory, which is of course a physical impossibility.

For example, on July 16, 1974, the CSIMS inventory status report listed 412 commodities with minus units on hand amounting to a minus inventory valuation of more than \$61,000.

According to department personnel, these minus units in inventory occur because of delays in processing stock receipt information into the system. They claim that stock sales information gets into the system faster than stock receipt information, even though both are batched daily for processing into the system. In fact, some stock receipt information does not get into the system until several months after the fact.

For example, the stock receipt information input into CSIMS for the month of November 1974, contains 158 transactions or adjustments amounting to a net increase to inventory of \$25,844.38 that are dated six months or more prior to November 30, 1974.

We did not make a detailed analysis as to the cause of minus units in the Central Stores inventory. Regardless of the cause, the fact remains that any time the quantity of a commodity in the Central Stores inventory, as shown in the CSIMS inventory status report, represents a minus number, the report is incorrect.

In addition to the unreliability of the CSIMS inventory status report, inventory management information is inadequate for determining how much of what commodities should be purchased and the proper amount of Central Stores inventory which should be maintained. In 1971, a "forecaster" was implemented into CSIMS. The purpose of the forecaster is to predict future Central Stores sales to state agencies, thus providing a basis for determining proper inventory levels. Because the current system is not maintaining adequate forecasting parameters, CSIMS predicted future sales are inaccurate and the Central Stores inventory does not reflect the needs of state agencies.

It is axiomatic that before future sales to state agencies can be predicted and anticipated, demand histories must be known. When CSIMS was designed, however, no provision was made to record and accumulate commodity demand histories. In fact, it was not until December 1973 that the system was enhanced to accumulate sales histories from December 1973 on. For forecasting purposes, demand history is far more important than sales history because a demand in one period may not be realized as a sale until another period, thus using sales history instead of demand history will distort any seasonal parameters built into any forecaster designed to predict future sales. Without accumulated demand histories, the CSIMS predicted sales to state agencies are of limited usefulness and inventory purchases that are made based upon those predicted sales are necessarily deficient.

In addition, the current CSIMS forecaster is not able to adjust quickly to a change in actual demand patterns. Also, the original system could not detect when the forecaster for a stock item was getting out of control. The system was enhanced in December 1973 to partially alleviate this situation, but additional work remains to be done.

Another CSIMS problem is that the difference between forecasted sales and actual sales is much larger than it should be. Because of this, safety-stock (a method of minimizing the running out of stock) cannot be calculated and implemented into the system. For the same reason, a method of screening out bad data cannot be implemented.

The above program problems, as well as other program problems not mentioned, have plagued the CSIMS since its inception. During the last two years, the system has been patched and repatched and yet the problems persist, with the result being an inability to properly manage or control the Central Stores inventory.

On January 17, 1975, the Chief of Procurement expressed concern over Central Stores inventory and the problems created by CSIMS deficiencies as follows:

"...I would caution only that, with present serious CSIMS malfunctions, increase in turnover rate will require considerable manual overriding of the CSIMS System. Without computer system assistance, we will increase the turnover at a much slower pace than would be possible if CSIMS was reliable."

"We begin 1975 seriously overinvested. Our goal is to reduce the inventory to its objective levels by the end of 1975 (before then if possible). Much depends on the 1975 market situation and the possibility of correcting CSIMS malfunctions during the 2-1/2 years of its remaining probable life before it is succeeded by SLAMM. No more profitable contribution to reducing cash flow problems could be made than correction of CSIMS deficiencies."
(Emphasis added)

Service Provided by Central Stores to State Agencies Deteriorated During Fiscal Year 1973-74.

In October 1971, Central Stores was able to fill over 92 percent of every order received from state agencies with an inventory of \$2,727,705. However, in August 1974, Central Stores was able to fill only 85 percent of agency orders in spite of the fact inventory had increased more than \$1.6 million.

In December 1971, the average processing time for Central Stores to fill an order was 4.77 days. In September 1974, the average processing time had increased 71 percent to 8.14 days.

In our judgment, the deterioration of Central Stores service and the Central Stores inventory problems are directly attributable to CSIMS deficiencies.

On January 27, 1975, the Supply Operations Manager for Central Stores described the inventory management problems created by CSIMS deficiencies as follows:

"CSIMS Forecasts and Order Quantity Recommendations

As I described to you, these elements of CSIMS data have lost virtually all of their reliability and accuracy. We cannot successfully (sic) manage our inventory for 2-1/2 years without reasonable reliable forecasts and sensible re-order recommendations. A much simplified interim technique should be developed to forecast and calculate re-order needs..."

From January 4, 1974 through September 2, 1974, Central Stores was unable to fill over \$1.2 million* in orders from state agencies. These stock outs result ultimately in additional costs to user state agencies because of additional costs involved in reordering unfilled orders, or, if the items are subsequently purchased on the open market, the higher price charged the user agencies.

Effective January 1, 1974, Central Stores discontinued the long standing practice of back ordering inventory items temporarily out of stock, i.e., the ordering of out of stock items to fill specific orders of individual state agencies without requiring the state agencies to resubmit the order. Currently, agencies are advised to wait 20 to 30 days and then reorder. However, there is no guarantee that the item will be in stock when the agency reorders. The process of ordering, reordering, and possibly reordering again, is time consuming, frustrating and wasteful for user agencies.

If, however, an agency cannot wait 20 to 30 days to reorder an item from Central Stores, it must then make a purchase through the Office of Procurement on the open market, which is usually more costly to the agency.

* Other factors besides CSIMS problems contributed to these stock outs, i.e., material shortages during 1974.

For example, we tested 57 separate purchases of Central Stores items purchased in bulk through the Office of Procurement between November 1973 and September 1974 and found that the Central Stores price was cheaper for 48 of the purchases tested, or 84 percent. The Office of Procurement prices, which represent individual open market purchases, averaged 28 percent more than the comparable Central Stores prices for these 48 purchases. The Office of Procurement usually will not purchase a Central Stores commodity on the open market unless Central Stores is out of stock for that commodity.

CONCLUSION

The Central Stores Inventory Management System is not functioning properly with the ultimate result being inadequate and unreliable inventory management information. It is essential that an inventory system be devised for Central Stores that will enable the Office of Procurement to effectively manage the Central Stores inventory.

RECOMMENDATIONS

We recommend that:

- The responsibility for custody of Central Stores inventory be separate from the record keeping function
- Computer program deficiencies in the Central Stores Inventory Management System be corrected

- Procedures be established to ensure that inventory status report information is both current and accurate
- Central Stores inventory level reflect actual demand levels
- Central Stores reinstitute the policy of backordering inventory items temporarily out of stock in order that state agencies would not be required to resubmit new orders for such items.

SAVINGS AND BENEFITS

Implementation of these recommendations will:

- Provide a separation of responsibilities which is essential to good internal control and reliable financial information
- Help ensure that CSIMS fiscal reports will be correct in the future
- Facilitate the development of accurate fiscal and inventory control reports
- Improve Central Stores service to state agencies
- Result in the avoidance of wasteful reordering by state agencies and an undetermined amount of reduced state expenditures for items purchased more economically through Central Stores than through the Direct Purchasing Unit of the Office of Procurement on the open market.

SUMMARY OF COMMENTS OF THE
DIRECTOR OF THE DEPARTMENT OF GENERAL SERVICES,
THE CHIEF OF PROCUREMENT AND STAFF

1. The department is currently, on a selective basis, making delegations of authority to various state agencies to make purchases in excess of \$25.
2. There are problems with the Office of Procurement making all purchases of \$25 to \$200, but a blanket statutory exemption of purchases up to \$200 is not the most appropriate answer.
3. The Department has developed a computerized management system called the State Logistics and Materials Management system (SLAMM). SLAMM is being implemented incrementally, commencing January 1976, as it is funded by the Legislature. That portion of SLAMM currently in the budget before the Legislature is designed to monitor contract volumes.
4. The department has received funds in 1975 to reinstate the Acquisition Analysis Unit. The funds received, however, were only one-half the funds requested.
5. That portion of SLAMM becoming operational in January 1976 will expand the commodity classification system of the Office of Procurement. Later, portions of SLAMM, not yet funded, will monitor vendor response, remove nonresponsive vendors from the prequalification list and accumulate data relative to purchases of specific commodities by state agencies.
6. CSIMS has had problems. SLAMM is designed to take care of these problems when implemented. In the meantime, we have attempted to modify CSIMS to make it as accurate and reliable as possible, i.e., we developed audit trail procedures and input control systems and procedures.