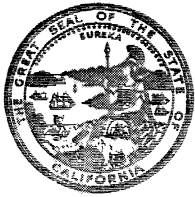


REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

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DEPARTMENT OF GENERAL SERVICES
OFFICE OF PROCUREMENT
PURCHASING POLICIES AND PROCEDURES

JUNE 1979



California Legislature

Joint Legislative Audit Committee

GOVERNMENT CODE SECTION 10500 et al

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June 12, 1979

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The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report concerning the purchasing policies and practices of the Office of Procurement, Department of General Services.

The report identifies a number of areas in the Office of Procurement's operation that need improvement. The cost to process smaller purchases generally outweighs the savings realized; much of the work performed in issuing purchase orders duplicates work already performed by state agencies; policies relating to small and noncompetitive purchases are sometimes ineffective and need improvement; the data management system is not performing up to expectations; and Central Stores' prices are not appropriate. The report notes that the Office of Procurement instigated many improvements during the audit and makes recommendations for further changes.

The auditors are William M. Zimmerling, Supervising Auditor; Steven L. Schutte; Arthur C. Longmire; Cora L. Bryant; and Ross Luna.

Respectfully submitted,

RICHARD ROBINSON
Assemblyman, 72nd District
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SUMMARY

The Department of General Services' Office of Procurement (Procurement) is responsible for purchasing state supplies and equipment in excess of \$100, except for purchases by the Legislature and the Regents of the University of California. Procurement is also responsible for purchases in excess of \$1,000 for the Trustees of the California State University and Colleges. To properly and economically make state purchases, Procurement is authorized to operate and maintain warehouses (Central Stores).

Our review of the Office of Procurement disclosed that its:

- Processing of purchases totalling \$500 or less does not substantially reduce costs and it typically approves specific items and suppliers state agencies request;
- Policies for procuring items which cost less than \$5,000 are sometimes ineffective and, in some cases, limit competition. Guidelines for noncompetitive purchases need improvement in that they do not require the buyers to justify exemption from competitive bidding or document their determination of a reasonable price;

- Excessive workload at the end of the 1977-78 fiscal year caused overtime hours for staff, disruption of services to agencies and inappropriate charging of backdated purchase orders;
- Management information system does not adequately monitor, measure and evaluate vendors and state purchasing programs;
- Warehousing operation's (Central Stores') rates do not compensate for financing costs.

To address these problems, we recommend that the Office of Procurement:

- Delegate a minimum \$500 purchase authority to all state agencies and delegate additional purchasing authority to select agencies;
- Minimize efforts in processing smaller purchases, improve competition on larger purchases, computerize informal bid lists, establish suitable noncompetitive purchase guidelines;
- Budget time and resources for increased workload at the end of each fiscal year;
- Establish priorities for its management information system to ensure its successful operation;

- Increase Central Stores' prices to finance operating costs.

During the course of our audit, the Office of Procurement began implementing many of these recommendations.

INTRODUCTION

In response to a resolution of the Joint Legislative Audit Committee, we reviewed the commodity procurement policies and practices of the Office of Procurement, Department of General Services. This review was conducted under authority vested in the Auditor General by Section 10500 et seq. of the Government Code.

The Government Code centralizes state commodity procurement authority in the Department of General Services. The department is responsible for:

- Making or supervising all state purchases of supplies and equipment in excess of \$100, except for purchases by the Legislature, by the Regents of the University of California and by the Trustees of the California State University and Colleges (who can make purchases below \$1,000);
- Establishing statewide purchasing standards;
- Pricing and distributing most state documents and publications;
- Establishing procedures for moving state shipments;

- Making purchases, upon request, for any city, county, district or other local government body;
- Operating and maintaining warehouses to properly and economically make state purchases.

The Director of General Services has delegated the authority to execute most of these responsibilities to the Chief of Procurement. The Chief of Procurement directs the State Office of Procurement, which operates two purchasing centers, a main office in Sacramento and a smaller office in Los Angeles. In fiscal year 1977-78, Procurement reportedly issued for state agencies approximately 47,300 purchase orders worth about \$155 million. Approximately 350 commodity contracts, with an annual value of almost \$58 million, were in force during 1977-78. Procurement also made approximately 1,900 purchases worth \$23 million on behalf of local governments.

Procurement operates redistribution warehouses, called Central Stores, in the Los Angeles and Sacramento areas. Central Stores sells and distributes basic supply items, which totalled \$13.9 million in sales during 1977-78 and state publications, with sales of \$1.8 million in 1977-78. These warehouses also rent and resell used equipment, rent warehouse space and store and distribute canned food to state institutions.

Office of Procurement operations are accounted for in the Service Revolving Fund. According to unaudited expense reports, Procurement collected \$20.7 million from customer agencies in fiscal year 1977-78 and expended \$19.7 million in its operations.

Scope of Review

We surveyed all Office of Procurement activities to identify areas warranting detailed audit efforts. Our audit included a review of 626 purchase orders to measure: (1) processing time, (2) compliance with established policies and procedures, (3) levels of competition and (4) staff effectiveness. We randomly sampled purchase orders dated from January through September of 1978.

During the review we also:

- Tested a number of selected commodity contracts for compliance with established policies and procedures
- Visited five state agencies to question purchasing staff about the level of Procurement's service and to identify specific procedural deficiencies

- Reviewed Procurement's billing rates and Central Stores' prices and cost records to determine whether amounts charged to customer agencies for products and services were appropriate.

At the time of our review, the Office of Procurement was involved in a number of projects which could result in substantial savings to the State. Examples of these projects include statewide programs for monitoring warehouse inventory and recycling steel furniture. Procurement management was very responsive to potential problems noted during our review and in most instances took immediate corrective action.

AUDIT RESULTS

THE OFFICE OF PROCUREMENT SHOULD DELEGATE MORE PURCHASING AUTHORITY

The Office of Procurement may not substantially reduce costs by transacting small dollar value purchases. In fact, its average cost of processing purchases under \$500 exceeds its average savings to individual agencies. For purchases under \$5,000, Procurement seldom changes specifications or vendor names which state agencies request. To reduce costs, shorten processing time and effectively renew contracts, the Office of Procurement should delegate more purchasing authority, especially for processing items under \$500. To successfully delegate purchasing authority, however, Procurement needs more accurate management information. Both the quarterly report and the income and expense reports should be modified to ensure that management is able to monitor all operations.

Processing Purchase Orders Less Than \$500 Is Generally Not Cost Effective

Procurement management states that, on the average, its buyers save state agencies five percent by purchasing items for them. However, based on 1977-78 data, we estimate that Procurement expends \$25 in processing smaller purchases. This figure approximates the average savings obtained for purchases

under \$500. Purchases less than \$500 constitute a substantial portion of Procurement's workload. We estimate that for the first nine months of calendar year 1978, 48 percent of purchase orders under \$5,000, which the express line unit handles, were below \$500.

Federal procurement regulations impose few restrictions on purchases costing \$500 or less. According to federal military regulations, the administrative cost of verifying the reasonableness of the price of purchases in this range may more than offset potential savings.

State Agencies' Purchase Specifications
and Suggested Vendors Are Usually Adopted

Most state agencies are not permitted by law to purchase supplies or equipment in excess of \$100 unless specifically authorized by the Office of Procurement. State agencies send formal purchase requests, called purchase estimates, to the Office of Procurement. State agencies may specify on these purchase estimates the quality of items to be purchased; however, Procurement can change the specification if the quality of the item is inconsistent with its purchasing standards. The purposes of purchasing standards are to ensure the necessary quality level of items purchased, permit consolidation of purchases in order to effect greater economy and

encourage competitive bidding. One of Procurement's goals is to conserve public funds through reduction in cost and improvement in the quality of materials purchased.

To determine how often Procurement revised agencies' specifications, we compared the quality specifications as submitted to Procurement to those it subsequently used on invitations to bid and on purchase orders. (In comparing specifications we did not consider the addition of standard bid instruction language as a change.) Procurement buyers may change an agency's specification or return the purchase estimate to the agency. Because Procurement does not retain records which indicate the number of estimates returned to agencies, we could not determine how often these were returned.

Our sample revealed that Procurement changed the quality specifications in 5 out of 414 purchase orders (two percent) under \$5,000. In two of these five cases, Procurement purchased the item the agency had originally requested. Furthermore, in a sample of Sacramento office formal bid purchases, those over \$5,000, the specification was changed 7 times in a sample of 60. Likewise, in three of the seven instances in which the specifications were changed, Procurement bought the same item the agency had requested. We also compared the names of vendors that state agencies suggested on purchase

estimates with the vendors Procurement awarded. Based on our sample, the Office of Procurement awarded purchases under \$5,000 to the suggested vendor 81 percent of the time.

State Agencies' Purchasing
Authority Can Be Increased

Based upon the preceding evidence, state agencies should be given increased purchasing authority. State agencies' present statutory purchasing limit is \$100. This limit could be increased to \$500 statutorily or through delegation by the Department of General Services. A change in the statutory purchasing authority would require an amendment to the Government Code. In this way, agencies could make purchases independently without the added cost and delay of processing items through the Office of Procurement. A disadvantage of a statutory change is that Procurement is unable to monitor statutorily exempt purchases.

As an alternative to amending the Code, Procurement could administratively delegate purchasing authority. Currently, Procurement has done so on a limited basis through the State Administrative Manual for specific commodities and through its Departmental Delegation Program to those individual agencies which have demonstrated procurement expertise. Most purchasing authority Procurement has delegated has resulted from requests by individual departments and agencies and information occasionally volunteered by Procurement buyers. However, Procurement has not

actively pursued a program of granting purchasing authority where viable opportunities may exist. Buyers have not been formally instructed to report instances of ineffective purchase order processing. Furthermore, staff at each of the five state agencies we visited stated they could accept increased purchasing authority without hiring additional purchasing personnel.

Purchase Order Processing and Contract Renewal Need Improvement

Another reason Procurement should delegate its purchasing authority is that its workload delays processing time for purchase orders and completion of contract renewals. These delays were the primary complaint of all state agency staff we interviewed. We found that Procurement's purchase order processing time is exceeding stated goals and that some general supply contracts are not being renewed before old contracts expire.

Purchase Orders

Based on a sample of 278 purchase orders issued by the Sacramento office during the first nine months of 1978, Procurement staff required an average of 23 working days to process express line orders (those under \$5,000) from the receipt of a purchase request to the issuance of a purchase order. Procurement's goal is ten working days. The express line solicits prices by telephoning or sending written price requests. Staff averaged 20 working days for telephone quotations and 33

days for handling written price requests. To process formal bid purchases (those over \$5,000) staff needed an average of 42 working days as compared with its goal of 30 days.

State agency staff members state that the purchase order processing delays are adversely affecting their operations. Projects have been delayed or cancelled. Paperwork has increased because more emergency purchases are necessary. Staff must pay higher prices because they are forced to purchase items in smaller quantities at mounting vendors' prices. Special shipments also have to be arranged.

The Chief of Procurement cited the following causes for the extended processing times:

- Buying staff must handle increased workloads because of executive emphasis on small and minority business awards
- Growing complexity of purchases
- Staffing shortages due primarily to the Governor's hiring freeze
- Excessively heavy backlog of work near fiscal year end
- Increased workload requirements of the new data management system.

Although there is considerable variation in the monthly workload level between Procurement's express line, formal bid and contracts purchasing units, the staffing of these units remains relatively uniform. During our audit, the Chief of Procurement acted to shift staff according to workload.

At the time of our review, Procurement's management information system had not produced reports necessary to monitor processing time and identify delayed purchase requests. However, the system began producing these reports in April 1979.

Contracts

Procurement issues term contracts for supplies and equipment such as envelopes, batteries, handtools and typewriters, items which state agencies consistently purchase in large volume. Agencies can usually order the commodities directly from the contractor without monetary limit. According to the Chief of Procurement, contracts should be made available to agencies on a timely basis. A memorandum issued by the Purchasing Manager states that contracts should be available to agencies 30 days before the prior contract expires.

Eighty-one (38 percent) of the 212 general supply contracts in effect on December 31, 1978 were not renewed before the expiration of the previous contract. An average time lapse of 58 calendar days occurred between expiration and renewal of these contracts. In addition, renewed contracts are not always

available to agencies until some time after the contract has been in effect. For example, the electric light contracts that expired on April 14, 1978 were renewed effective June 16, 1978, but were not mailed to state agencies until August 1, 1978.

Personnel at the five state agencies visited mentioned the inconvenience that these delayed contract renewals caused. Agency staff members stated that, as with delayed purchase orders, they made small purchases during the interim period and paid higher prices.

The Chief of Procurement explained that contract renewals were untimely for the same reasons that purchase order processing time was excessive. In addition, the contract unit supervisor identified 12 contracts which were not renewed in a timely manner for reasons beyond the control of the Office of Procurement: the paper strike, the Governor's freeze on furniture and stationery items and vendor protests to the Board of Control.

Successful Delegation of
Purchasing Authority Depends
Upon Management Information

Management within the Office of Procurement will be able to more effectively delegate purchasing authority to state agencies if it is continually apprised of procurement operations

and expenditures. Two kinds of reports--the quarterly report and the monthly income and expense report--need improvements so that they can better inform management.

Quarterly Reports

Procurement's management information system produces a quarterly report that is supposed to assist management in identifying potential areas for delegation of purchasing authority. The report is a listing of all supply items purchased during a calendar quarter showing the number of times the item was purchased and the dollar volume. But according to Procurement staff responsible for recommending purchase delegations, this report has limited uses because of its format. There are no formal plans to improve the report.

Monthly Income and Expense Reports

The Office of Procurement is furnished monthly income and expense reports by General Services' accounting office. Presently, Procurement's income and expense reports combine the costs and revenues of different activities and types of services. For example, the costs and revenues associated with express line purchase orders, formal bid purchase orders and annual commodity contracts are combined into one category. In 1977-78, revenues exceeded expenses by 34 percent for the three activities combined; however, the performance of the individual activities cannot be readily identified. According to Procurement staff,

the accounting office can redesign the reports upon request. Separating the revenues and expenses of each unit's activities would allow management to compare costs of its individual operation against its estimated savings. This modified report would also enable Procurement to assess the appropriateness of its individual billing rates to customer agencies.

CONCLUSION

The Office of Procurement should delegate more purchasing authority, especially for purchases below \$500, to state agencies. Its current processing of items under \$500 is not cost-effective; furthermore, it usually adopts specifications or vendor names for purchases totalling less than \$5,000. Because of its workload, Procurement does not efficiently process purchase orders or expedite timely contract renewals. To ensure the effective delegation of purchasing authority, Procurement management needs accurate information.

RECOMMENDATION

We recommend the Office of Procurement:

- Delegate a \$500 purchasing authority to all state agencies

- Initiate the delegation of additional purchasing authority under the Departmental Delegation Program
- Annually reassess the appropriate level of general purchasing authority to be given state agencies
- Redesign the present management information reports to better accommodate delegation management staff
- Reorganize its income and expense reports to separate costs and revenues into method of processing and billing method
- Formally instruct buyers to report instances of ineffective purchase processing to the Departmental Delegation unit.

MATTERS FOR CONSIDERATION
OF THE LEGISLATURE

The Legislature may wish to consider raising state agencies' statutory purchasing authority to \$500 if Procurement does not delegate its purchasing authority as recommended above.

CERTAIN PURCHASING ACTIVITIES
NEED BETTER DIRECTION AND CONTROL

Some pricing and purchasing policies in the Office of Procurement need revision to establish more formal guidance in certain purchasing areas. Policies for smaller express line purchases should be changed to minimize efforts associated with processing purchases under \$500 and improve competitiveness of purchases over \$500. For noncompetitive purchases, there is little policy guidance for determining reasonable prices, justifying purchases and documenting this justification. This lack of guidance may disallow equal opportunities to vendors or cause buyers to procure higher priced items. As a result of our review, Procurement has taken action to consolidate and improve some of its policies and practices. This action should be continued to include all phases of its purchasing operation.

Express Line Policy Needs Revision

The express line unit procures purchases under \$5,000. Express line buyers are directed by policy to request price quotations from both the vendor the requesting agency suggests and at least one other vendor known for bidding a low price.

Purchases Under \$500 Require Minimum Effort

The express line policy extends to purchases totalling less than \$500. As previously discussed, Procurement's administrative costs of processing these purchases approximate the average price savings. Also, federal procurement regulations allow buyers to purchase items \$500 or less without securing competitive quotations if the prices are considered reasonable and such purchases are distributed among qualified suppliers. Our sample indicated that the vendor suggested by the agency was awarded the purchase 82 percent of the time for purchases under \$500. When Procurement contacted more than one vendor, it chose the referenced vendor 60 percent of the time.

Expanded Vendor Selection Would Improve Competitiveness of Purchases Over \$500

Despite Procurement's policy to request two or more price quotations for purchases over \$500, buyers do not always obtain them. In a sample of purchase orders over \$500, only one price was obtained 31 percent of the time that two or more vendors were contacted. It is significant that Procurement requires other state agencies with purchasing authority to obtain two prices on all purchases over \$100.

Other public entities also require their buyers to obtain two price quotations. For example, the California State University and Colleges requires two prices on its purchases of \$400 or more, and federal procurement regulations require two prices on all purchases over \$500.

Presently, buyers manually select vendors and exercise personal discretion when choosing them. They state that selecting and contacting additional vendors will take additional staff effort. But Procurement's computer technicians stated that their computer could automatically select four or five vendors at random. In this way, vendor names, addresses and telephone numbers could be available to the buyer at the same time he receives the purchase request. The random selection of vendors would provide equal opportunities for all vendors to bid on state business.

During our audit, the Office of Procurement revised its express line policy. Buyers are now instructed to obtain at least two price quotations when possible. If only one quotation is received after three contacts, the buyer decides whether to contact additional vendors.

Guidelines for Noncompetitive Purchases
Need Improvement

The Office of Procurement has not established formal criteria for determining reasonableness of prices for noncompetitive purchases. In addition, there are no formal procedures to guide buyers in justifying noncompetitive purchases or documenting their justifications.

Criteria for Judging
Reasonableness of Prices Needed

The Office of Procurement has not established formal criteria or guidelines for buyers to follow in determining reasonableness of prices for noncompetitive purchases. For purchases over \$500, federal procurement regulations require the buyer to document the basis of determination of fair and reasonable price in the purchase order files. This determination may be based on a comparison of the proposed price with prices found reasonable on previous purchases, current price lists, catalogs, advertisements, similar items in related industry, value analysis, the buyer's personal knowledge of the item being purchased or any other means. When only one source is solicited, an additional notation is required to explain the absence of competition.

Justification and Documentation
Procedures Needed

The Office of Procurement has not established procedures for buyers to follow in justifying noncompetitive purchases or in documenting such justification. As a result, a sample of purchase orders over \$5,000 demonstrated limited evidence of compliance with the Government Code and the State Administrative Manual.

Sections 14807 and 14809 of the Government Code specify that all purchases in the amount of \$5,000 or more must undergo a competitive bid process unless:

- The requesting agency and the Department of General Services (Office of Procurement) agree that an article of a specified brand or trade name is the only article which will properly meet the needs of the agency, or unless
- An emergency dictates that an immediate purchase is necessary for the protection of the public health, welfare or safety.

Eighty-two purchase orders in amounts over \$5,000 within our sample of 212 had not undergone a competitive bid process. Nine of the 82 purchase order files did not contain evidence of either (1) agreement with the requesting agency or (2) an emergency as required by the Government Code. We contacted personnel of the requesting agency about purchases which did not demonstrate

compliance with the law. In seven instances the agency had not requested a noncompetitive purchase. In three cases agency staff knew of multiple vendors that could have been potential bidders. And in two instances we were able to contact the suggested vendors and were informally quoted prices competitive with those the Office of Procurement had obtained.

The Government Code also requires the Office of Procurement to report all noncompetitive purchases over \$5,000 to the Board of Control. Two of the 82 noncompetitive purchases sampled were not reported as required. However, the Office of Procurement has taken action to establish a procedure to ensure full reporting in the future.

The State Administrative Manual requires agencies requesting a noncompetitive purchase to include a justification containing certain information from the manual. Thirty-one of the 82 purchase order files did not contain any of this required information. If this limiting of competition is not justified, the State may be paying higher prices for items purchased. In addition, restrained competition does not afford all vendors an equal opportunity to sell their products to the State.

Office of Procurement policy dictates that management is to approve all noncompetitive purchases over \$5,000 in advance. We were unable to confirm compliance with this policy because the approval forms were reportedly discarded by clerical

staff. These forms may have also contained some justification data not otherwise available in the file. During our audit, the Office of Procurement began retaining these forms.

Established Policies Are Not Being Followed

At the beginning of our audit, all laws, regulations, policies and procedures applicable to the Office of Procurement's purchasing operations were contained in various documents and memos issued on different dates and were scattered throughout the office. The last published buyers' manual was issued in 1966 and covered only procedural matters on the express line operation. In our opinion, all staff should have ready access to current policy and procedure guides. Also, these guides should be updated and kept current.

Following are some problems, not previously mentioned, indicating that staff needs some policies clarified. Express line buyers were not always contacting two vendors for price quotations as policy required. In a sample of 414 purchase orders under \$5,000, only one vendor was contacted 189 (47 percent) times. There is no established policy for vendor selection for noncompetitive purchases under \$5,000.

Also, referenced and write-in vendors may not always be sent a bid invitation. It is Procurement's policy to mail formal bid invitations to any vendor the ordering agency suggests. We

noted two instances in our formal bid purchase order sample in which referenced vendors were not sent bid invitations. In one instance, the omitted vendor had quoted the ordering agency a lower price than the Office of Procurement had later obtained from another source.

Overall, staff members have different interpretations of certain policies. There was general misunderstanding about express line policies among all levels of staff. Supervising buyers cited different conditions that would justify an emergency noncompetitive purchase. State agency staff stated that the criteria for emergency purchase authorization varies from buyer to buyer.

Near the close of our audit, the Office of Procurement issued a consolidated purchasing policy and procedural guide. In addition, it produced the "Buyer's Policy Manual," a buyer's guide for transacting express line purchases. These manuals, however, omit some Procurement processes such as contracts, state price schedules and restricted bid lists. Procurement has assigned staff to begin covering these areas.

CONCLUSION

The Office of Procurement should revise its policies to establish more guidance in certain purchasing areas. The express line policy needs revision to deemphasize pricing efforts for purchases \$500 or less and to

improve competition for purchases over \$500 by requiring at least two price quotations for competitive type purchases and by selecting bidders with the computer.

There is little formal policy concerning noncompetitive purchases. To reduce any unnecessary limiting of competition, buyers should be required to document the reasons for limiting competition and should also document their basis for determination of a fair and reasonable price.

RECOMMENDATION

We recommend that the Office of Procurement:

- Revise its express line policy to: (1) allow buyers to purchase items costing \$500 or less without securing competitive quotations if the prices are considered reasonable and such purchases are fairly distributed among qualified suppliers, and (2) to require two or more price quotations on purchases over \$500;
- Produce with its computer informal bid lists of randomly selected vendors for each express line purchase. The referenced vendor should continue to be solicited and buyers should still exercise discretion in selecting vendors;

- Establish formal noncompetitive purchase guidelines, including but not limited to:
 - (1) Criteria such as prices found reasonable on previous purchases, current price lists or value analysis
 - (2) Justification criteria as established in the State Administrative Manual
 - (3) Documentation requirements for purchases over \$500 which would address the need for limiting competition, determining reasonableness of price and complying with law and policy;

- Continue to develop its newly formed policy guidelines to include all its purchasing processes, such as contracting and price schedules of purchase orders.

EXCESSIVE YEAR-END WORKLOAD
RESULTED IN BACKDATED PURCHASE ORDERS

The Chief of Procurement agreed to process a large number of purchase requests between May 1 and June 30, 1978. Many of these requests were not justified in accordance with the State Administrative Manual. Purchase orders were backdated; consequently, expenditures were charged to appropriations that had legally expired. The heavy year-end workload also adversely affected other Office of Procurement functions.

Backdated Purchase Orders

The Government Code Section 16304 states that an appropriation shall be deemed to be encumbered at the time a valid obligation against that appropriation is created. In the opinion of the Legislative Counsel, state funds are legally obligated on the date a purchase order is sent to the vendor.

The Office of Procurement issued a number of purchase orders, dated June 30, 1978, which were actually transmitted to the vendor in July and August; some were sent as late as December. We estimate that over 1,000 purchase orders were backdated to June 30, 1978. The Chief of Procurement stated that this practice had sometimes occurred in prior years.

The date of a purchase order normally determines the fiscal year appropriation to which the expenditure is to be charged (California Administrative Code Section 610). The State Controller relies upon Procurement's purchase order date to ensure that state agencies charge expenditures to the proper fiscal year appropriation. Because purchase orders were backdated, agencies charged purchases to appropriations that had legally expired.

The Chief of Procurement stated that purchase orders were backdated because his office was unable to complete the timely processing of a large number of purchase requests accepted near the end of the fiscal year. He also stated that occasionally there are uncontrollable circumstances which delay the award of a current year purchase into the following fiscal year.

There may be some extraordinary circumstances preventing the timely award of purchases, such as a vendor protesting a bid award to the Board of Control. The acceptance of purchase requests near the end of the fiscal year, however, is within the discretion of the Chief of Procurement. Neither the Board of Control nor the Department of General Services has the authority to designate the appropriation to which a purchase is charged in cases of unavoidable purchasing delays.

Office of Procurement Is Not
Effectively Controlling Its
Fiscal Year-End Workload

May 1 is the established deadline for purchase requests chargeable to appropriations expiring on June 30. In May and June of 1978, the Office of Procurement agreed to process approximately 4,800 purchase requests in the Sacramento office. According to the State Administrative Manual (SAM), the Office of Procurement may accept requests chargeable to current year appropriations after May 1 if:

- There is a full explanation approved by the department's chief administrative officer
- The purchase is either (1) required by an emergency involving public health, welfare or safety or (2) funded by an appropriation expiring June 30 or earlier, which was not available before April 15.

SAM also requires that state agencies indicate on purchase requests whether their funding is continuing or expiring. Twenty-seven purchase requests in our sample of 294 Sacramento office purchase orders were submitted to the Office of Procurement after May 1, 1978. We measured these requests against the foregoing SAM criteria. Sixteen of the 27 purchase requests did not indicate whether funding was expiring on

June 30, 1978 or continuing into the next fiscal year. Of the nine that indicated expiring funds, eight did not have the required explanations or conditions for late submission.

The Chief of Procurement stated that he also accepts late purchase requests based upon discussions with agency staff. In particular, the 1977-78 fiscal year-end workload was exceptionally heavy because he gave special permission to process:

- Purchases made in connection with improvements to state hospitals
- Department of Transportation purchases
- Purchases made in connection with Federal Title II public works employment projects.

According to the Chief of Procurement, these purchases were necessary because of reported changes in appropriations or availability of funds. Upon further examination, we found that the Chief of Procurement may have been misinformed about funding for the Department of Transportation and Title II purchases.

Since the Budget Act of 1977 took effect on July 1, 1977, some of the Department of Transportation's appropriations were funded for each fiscal year. Prior to the passage of this act, the state highway program received continuous funding. The Chief of Procurement stated that Department of Transportation

staff advised him in March or April of 1978 that funding was on a continuing basis. In late June, however, he was told that funding was expiring on June 30, 1978 instead. Of the ten Department of Transportation purchase requests in our sample, nine did not indicate funding status, five were backdated and nine were eventually charged to appropriations available in the following fiscal year (1978-79).

One purchase request connected with Title II in our sample of 27 requests was submitted after the May 1 deadline. It was charged to an appropriation which was available on July 1, 1977 and which would expire on June 30, 1978. According to requesting agency staff, the project was initiated late in the fiscal year to use remaining budgeted funds.

Our sample of 27 purchase requests accepted for processing after the May 1, 1978 deadline can be ordered as follows: 10 were submitted by Department of Transportation, 7 were submitted by state hospitals and 1 was designated Title II. Nine did not fit any of the above categories. All nine were approved for late processing by procurement management. Seven of the nine purchase requests were not in compliance with late submission procedures prescribed in the State Administrative Manual.^{1/} Two of the 27 purchase requests could have been processed in the following fiscal year. Both purchase requests

included notations indicating that their appropriations were available in 1978-79. One was dated June 29, 1978 and the other was unnecessarily backdated to June 30, 1978.

To process the large number of year-end purchase requests, buying staff and clerical staff worked overtime. Most of the staff received pay at time and a half for this work, while a few received compensating time off. The extra effort devoted to the heavy year-end workload also affected other Procurement operations. For example, renewal of supply contracts was delayed as discussed in the first finding of this report and Central Stores' service level declined.

CONCLUSION

The Office of Procurement accepted a large number of purchase requests after the May 1 deadline for the 1977-78 fiscal year. As a result, employees had to work overtime at additional state cost, service to agencies declined and a large number of purchase orders had to be backdated. This predating caused expenditures to be charged to appropriations that had legally expired. Finally, the Chief of Procurement is not enforcing the State Administrative Manual provisions which were designed to restrict, control and establish priorities for end-of-year work.

RECOMMENDATION

We recommend that:

- The Office of Procurement date purchase orders with the date of transmission to the vendor
- The Chief of Procurement control fiscal year-end workload by more strictly enforcing the applicable State Administrative Manual provisions.

MATTERS FOR CONSIDERATION BY THE LEGISLATURE

The Legislature should consider allowing the Board of Control to designate the appropriation to which a purchase is charged in cases of unavoidable purchasing delays as justified by the Director of General Services.

In addition, the Legislature should consider requiring state agencies to submit to the Department of General Services purchase requests chargeable to expiring appropriations no later than May 1, or as early as the Director of General Services may prescribe. The Director should be authorized to establish specific circumstances which would allow exceptions.

DATA MANAGEMENT SYSTEM HAS HAD
LIMITED SUCCESS

The Statewide Logistics and Materials Management (SLAMM) information system has had limited success. Some purchasing reports were not available 18 months after the system became operational. Our audit tests indicate that some problems which the new system should have corrected still exist. Specifically, we found that vendor lists are sometimes incomplete, nonresponsive bidders have remained on bid lists, and state agencies' delegated purchases and contract expenditures were not being monitored.

SLAMM Background

The SLAMM system is a computer-based management information system which will eventually assist in the acquisition, storage and distribution of commodities statewide. The system consists of two major segments developed in phases. SLAMM 1, the first segment, incorporates phases I through VII and is concerned with procurement; SLAMM 2, developed in Phases VIII through XI, is an inventory management tool. Our audit reviewed only SLAMM 1 procurement.

Some Purchasing Management
Reports Are Unusable

With the implementation of the SLAMM purchasing management information system, the manual system of recording purchasing data was discontinued. SLAMM was reported to be operational in phases as follows:

Phases I through IV	July 1, 1977
Phases V and VI	August 1, 1977
Phase VII	July 1978

Despite these dates for implementing SLAMM, some Phase IV purchasing reports were unusable eighteen months after the system was declared operational in July of 1977. Four of the 12 management reports produced in Phase IV essential for monitoring and evaluating the purchase function were not produced in a usable form until January 1979 or later. These reports were:

- Buyer Workload Status--This report is a management tool for measuring performance and allocating workload. Procurement management stated that it was available July 1, 1977, but was not used until January 1979 because they lacked confidence in the data. In addition they cited that the report's format was inadequate.

- Open Purchase Estimates--This report lists in-house purchase estimates and also indicates how long an estimate has been in-house. Procurement managers stated they did not use this report until January 1979 because they doubted the reliability of the data.

- Open Purchase Estimates Over 60 Days--This report lists purchase estimates which have not been closed out by a purchase order within 60 days of their receipt. It was not a required report in the original SLAMM specifications and was first produced in January 1979.

During our audit, we noted that several purchase estimates in the Office of Procurement were not acted on for periods up to 71 calendar days. The three reports discussed above could have targeted these purchase estimates for management attention and corrective action.

- Processing Time by Procurement Method--This report assists managers in measuring and evaluating processing time of various transactions in the Office of Procurement. Although reportedly available in July of 1977, it was not used until July 1978 because staff lacked confidence in the data and stated that its format was inadequate.

Staff members are developing a revised processing time report, which they estimate will be available in June 1979.

Since SLAMM was implemented, the time required to process a purchase estimate has gradually increased. For a detailed review of processing time, see page 12 of this report.

Bid Lists Are Sometimes Inaccurate

Vendors wishing to sell to the State are prequalified by the Office of Procurement to receive bid invitations. Prequalification is based upon the vendors' ability, resources and facilities to adequately supply products to the State. Vendors seeking prequalification identify items which they wish to bid on and the geographic areas in which they can provide their products. This information is fed into a computer which yields a bid list for each stock item. All vendors appearing on a bid list are normally mailed bid invitations for all formal bid purchases over \$5,000. Most items purchased by the State are coded by number and classified in the SLAMM stock item catalogue.

Auditor General reports in 1975 and 1978 noted poor responses to bid mailings. During this audit, we again verified this low response level. We conducted a random sample of 127 formal bid transactions (over \$5,000) at the Sacramento and Los Angeles offices to check the level of responses. The results are listed below:

	<u>Sacramento</u>	<u>Los Angeles</u>
Number of Bids Mailed	4,778	3,582
Number of Bid Responses	287	214
Percent of Bid Responses	6.01%	5.97%

Our sample and a Procurement study indicate a low percentage of vendors are responding to invitations to bid. The high level of nonresponses can be partially attributed to inaccurate bid lists. One problem is that vendors who do not respond after three consecutive calls for bid are not removed from prequalified bid lists, as the Administrative Code Section 1891 requires. Our review of the disqualified vendor file showed that no vendors had been removed because they failed to respond to three consecutive calls for bid. In fact, vendor responses to bid invitations were not being monitored by SLAMM until November 1978. As of March 1979, though, staff began mailing the first letters of intent to remove vendors from bid lists.

According to data management staff, other inaccuracies in the bid lists occurred because they were based upon a questionnaire which permitted vendors to check off broad groups of items or indicate specific items they could supply. Since some vendors checked only the broad item groups, Procurement now sends a revised questionnaire requiring specific responses. Also, buyers have been directed to check the computer-produced bid list to ensure known sources of supply are included.

Bid lists are also incomplete. An objective of the SLAMM data system is to produce a complete computerized list of responsive bidders. In our sample of competitive bid purchase orders over \$5,000, we noted one instance in which bid invitations were not mailed to all prequalified vendors able to provide the specified product. The vendor awarded the purchase and the vendor ultimately supplying the item were not sent invitations to bid.

One of the vendors had seen the bid invitation posted at the Office of Procurement. Both vendors stated that the State's bid mailing system is not reliable. The buyer handling this purchase did not check the bid list as he should have. He stated there was not sufficient time to do so.

Many items were incorrectly coded and classified because staff was unfamiliar with the new SLAMM coding system. A revised supply catalogue with most errors corrected was issued in April 1978.

Contract Orders Need to Be Monitored

The Office of Procurement establishes term contracts for commodities which are purchased repetitively and in large volume. State agencies can order the commodities directly from the contractor without monetary limit.

Currently, the Office of Procurement relies upon contractors to report expenditures from contracts each quarter. When renewing contracts, buyers usually have only one-half the prior year's consumption data, because they have not received contractor's quarterly reports before they develop specifications to bid new contracts. This reliance on information supplied by contractors is a problem which was included in Auditor General reports in 1969 and 1975. These reports criticized the Office of Procurement for relying on contractors to report the amount of contract orders and to determine when the contract is completed. They also suggested that Procurement should independently develop the volume of contract purchases.

Also, the SLAMM system specification (February 1977) states that data supplied by the contractors is unreliable and too general for effective contract management. The specification also states that:

An existing contractor has a competition advantage over other bidders since he is the only one who knows exactly what the state is buying and where it is delivered.

An unethical contractor could distort the quantity of purchases between various items (i.e. reporting some as higher and others lower than actual) in order to make his bid price appear lower than it is in fact.

Without objective information, the Office of Procurement cannot independently determine when a contract should be rebid, extended or when the contractor has fulfilled his contractual obligation.

SLAMM Phases V/VI which was reportedly operational on August 1, 1977, could eliminate buyer's reliance on data that contractors supply. These phases were designed to capture contract consumption data from copies of the actual contract orders. Although state agencies have been submitting copies of their contract orders since July of 1977, the system was not ready to process them even on a limited basis until March 1979. Another limitation is that agencies are not submitting copies of all contract purchases and those which have been submitted contain errors. Because of this incomplete and inaccurate information, the system is capturing and processing only a portion of the data from the order forms. Data management staff estimate that a successful system may require up to three years.

The State Controller's data system is programmed for redesign. A feasibility study is planned for this calendar year. State Controller personnel advised it might be possible to accumulate expenditures against contracts as warrants are issued to contractors. This data could be provided to the Office of Procurement to effect better contract monitoring.

Departmental Purchasing Delegations
Need to be Monitored

State agencies are required to submit a copy of all delegated purchases to Procurement. Based on this information, SLAMM Phase VII, Delegations Management, was designed primarily to monitor authorized state agency purchases. This phase should

help ensure that state agencies use their delegated authority properly. In addition, the recapture of delegation expenditures will identify supply items which could be more efficiently purchased by contract or some other method.

The system was reported operative July 1978, according to the January 15, 1979 Department of General Services quarterly progress report. Orders were not processed until February 1979 because the system needed modifications. As of April 11, 1979, no reports had been issued. Procurement staff were manually reviewing delegation purchases and estimate that state agencies were submitting only 60 percent of the orders.

CONCLUSION

The SLAMM information system has not achieved its goal of providing a data system to accumulate information to monitor, measure and evaluate vendors and state purchasing programs. The problems associated with bid lists, low bidder response rates and lack of independent data on contract expenditures continue to exist. Also, the monitoring of purchases delegated to state agencies is limited. In general, the inability of agencies to provide accurate and complete purchasing information has adversely affected the basic data collection process. Management reports have been delayed; consequently, management has been restricted in monitoring the internal processing of purchasing transactions.

RECOMMENDATION

We recommend the Office of Procurement:

- Establish specific completion dates and priorities for implementing the purchasing phases of SLAMM, particularly management report deficiencies, refinement of bid lists and collection and submission of contract and delegation order data;
- Reinstruct buyers to check SLAMM bid lists for known sources of supply until system improvements are implemented;
- Propose to the State Controller that he consider accumulating contract and departmental purchasing delegation data for the Office of Procurement;
- Schedule periodic SLAMM training sessions for agency purchasing personnel.

CENTRAL STORES' PRICES
SHOULD BE REVISED TO RECOVER
ALL APPROPRIATE COSTS

Central Stores' prices do not provide for the accumulation of the capital (cash) needed to conduct day-to-day activities. Instead, the Department of General Services has increased its rates to agencies for purchasing services. Since Central Stores' prices, when compared to those of private suppliers, are an indication of its efficiency and effectiveness, these prices should accurately reflect costs.

Central Stores Prices
Should Reflect All Its Costs

As stated in both the Summary and Introduction of this report, the Government Code authorizes the Office of Procurement to maintain warehouses to properly and economically make state purchases. According to Procurement's Materials Management Manual, its warehouses in Sacramento and Los Angeles handle items which require testing or which, through volume purchasing, can be housed at one point and redistributed at savings to the State. Customer agencies can identify such savings when they compare the price of Central Stores' products to the price of the same products from other sources.^{2/} However, these savings are not actual unless Central Stores' prices reflect all of its costs--including costs of accumulating needed cash.

Purchasing Rates Increased
to Cover Cash Deficiency in
Central Stores

For years the Office of Procurement has not reserved sufficient cash to finance its expenditures. Instead, Procurement has had to rely upon cash advances from customer agencies and cash provided by other Department of General Services' operations. In attempt to increase its cash position, it has increased the rates charged to state agencies for purchasing services approximately nine percent in fiscal year 1976-77 and again in 1977-78. Procurement's cash shortage is occurring, however, in the Central Stores operation, whose rates remain the same. This shortage is illustrated by the following table showing year-end cash balances for both purchasing and Central Stores for the last two fiscal years.

	<u>Cash Account Balances*</u>	
	<u>June 30, 1977</u>	<u>June 30, 1978</u>
Purchasing	526,000	964,000
Central Stores	<u>(\$1,456,000)</u>	<u>(\$2,348,000)</u>
Total Office of Procurement	<u>(\$ 930,000)</u>	<u>(\$1,384,000)</u>

*Source: Unaudited data provided by the Department of General Services, Fiscal Reports Section.

According to information obtained from the Department of General Services' budget office, Central Stores' prices were intentionally unchanged because they would unfavorably compete

with prices in the private sector. It is an objective of the Department of General Services to set prices based upon the value of the product or service being provided.

CONCLUSION

The Office of Procurement's deficient cash position is due primarily to the operation of its Central Stores. The burden of accumulating the needed cash, however, has been recently placed upon its purchasing operation reportedly to keep Central Stores' prices competitive with the private sector. Central Stores' prices should include all costs of its operation, and the Department of General Services should reconsider its objective of setting prices based on market values. Central Stores' existence is justified by the actual savings it produces for state agencies.

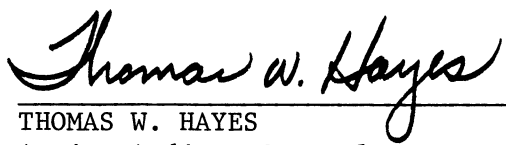
RECOMMENDATION

We recommend that the Department of General Services set its prices based on cost rather than market value.

We further recommend that the Office of Procurement decrease its charges for purchasing services and correspondingly increase Central Stores' prices as necessary to recover needed cash in accordance with its working capital plan.

In the event these actions exempt certain stores' items from competition, we recommend that the Office of Procurement examine alternative methods such as purchasing these items directly or contracting for them.

Respectfully submitted,


THOMAS W. HAYES
Acting Auditor General

Date: June 7, 1979

Staff: William M. Zimmerling, Supervising Auditor
Steven L. Schutte
Arthur C. Longmire
Cora L. Bryant
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FOOTNOTES

- 1/ During our audit, the Office of Procurement issued a memorandum to all state agencies re-emphasizing the SAM requirement to indicate funding status on purchase requests.
- 2/ State agencies are not required by statute to purchase supplies from Central Stores.

Memorandum

Date : June 6, 1979

File No. :

To : Mr. Thomas W. Hayes
Acting Auditor General
925 - L Street, Suite 750
Sacramento, California 95814

Subject : Report 858

From : **Department of General Services**

We appreciate the opportunity to review the findings contained in the draft report of the Auditor General covering State procurement practices. We are in agreement with and have taken action to implement many of the recommendations contained in the draft report.

Our specific responses to each of the nineteen recommendations contained in the draft report are attached.

I would like to express my appreciation for the open and cooperative attitude of your staff during their review of our procurement activity.



David E. Jan
Director of G



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Attachments

RESPONSE TO RECOMMENDATIONS CONTAINED
IN AUDITOR GENERAL'S DRAFT REPORT 858,
JUNE 1979.

1. Delegate a \$500 purchasing authority to all state agencies.

The Office of Procurement; in addition to its on-going special delegation program, has implemented a pilot program with four departments/board; Transportation, Employment Development, Justice, and the State Personnel Board granting them full purchase authority up to \$500. This pilot study was initiated May 7, 1979, and will conclude August 7, 1979. Our intent is to evaluate the pilot at that point and if successful, implement the program statewide with all agencies.

2. Initiate the delegation of additional purchasing authority under the Departmental Delegation Program

The identification of commodities and departmental needs is an on-going portion of our Delegation Program. Problem purchasing areas are identified by the individual departments, our buyers, and the Office of Procurement Statewide Inventory Team. The Delegation Program has grown from \$6 million to \$12 million in the past three years reflecting the commitment of the Office of Procurement management to the program. We plan to continue our expansion efforts.

3. Annually reassess the appropriate level of general purchasing authority to be given state agencies

With the implementation of the \$500 delegation on a statewide basis, we will annually review the inflationary factor as to its impact on the purchasing power of the State departments. A savings vs. cost analysis will be prepared in order to determine the appropriate increase to the purchase authority level.

4. Redesign the present management information reports to better accommodate delegation management staff

Revisions to the management information reports will be developed as required to meet the needs of the delegation program.

5. Reorganize its income and expense reports to separate costs and revenues into method of processing and billing method

Implementing this recommendation would facilitate the review of the cost effectiveness of the various purchase techniques utilized by the Office of Procurement. Reformating the income and expense statements and invoice processing will result in some increase in accounting and data processing costs. The magnitude of the cost increase must be determined and compared with the

5. (continued)

cost of manually extracting the data necessary to evaluate the cost effectiveness of the various purchase processes. A decision on implementation of this recommendation will be withheld until the cost data can be developed.

6. Formally instruct buyers to report instances of ineffective purchase processing to the Departmental Delegation unit.

This recommendation is being adopted and appropriate revision will be made to the Buyer's Policy Manual.

7. Revise its express line policy to: (1) allow buyers to purchase items costing \$500 or less without securing competitive quotations if the prices are considered reasonable and such purchases are fairly distributed among qualified suppliers, and (2) to require two or more price quotations on purchases over \$500;

This recommendation has been adopted and our express line policy manual is being revised to reflect this change.

8. Produce with its computer informal bid lists of randomly selected vendors for each express line purchase. The referenced vendor should continue to be solicited and buyers should still exercise discretion in selecting vendors;

This recommendation has several advantages which make it attractive; (1) it assures all prequalified vendors an equal opportunity to compete for the State business, (2) it reduces the buyer's time in searching for vendors, etc. A determination of the cost of producing this informal bid list will have to be made in order that a decision can be made considering the cost vs. benefits.

Additionally, a determination will be made as to what impact this change will have on processing time.

9. Establish formal noncompetitive purchase guidelines, including but not limited to:

(1) Criteria such as prices found reasonable on previous purchases, current price lists or value analysis

(2) Justification criteria as established in the State Administrative Manual

(3) Documentation requirements for purchases over \$500 which would address the need for limiting competition, determining reasonableness of price and complying with law and policy;

This recommendation is being adopted and a memo implementing this policy will be issued within 30 days. The Buyer's Policy Manual for Express Line operation will be revised to reflect this policy.

10. Continue to develop its newly formed policy guidelines to include all its purchasing processes, such as contracting and price schedules of purchasing orders.

The referenced policy guidelines have historically been available in the form of: S.A.M. sections, Administrative Orders, departmental and division policy memos, etc. We are actively working on an integrated policy manual which will combine all these policy statements into one document to assure ready accessibility to complete policy by all staff members. We have already completed the Express Line portion and our schedule for completion of the Manual is as follows:

A. Formal Bid: September 1, 1979

B. Contract: December 1, 1979

11. The Office of Procurement date purchase orders with the date of transmission to the vendor

The procedure followed by the Procurement Office in accomplishing purchases in the month of July which utilized the funds from the past fiscal year was a practice that has had precedent in prior years. It is our belief that when circumstances develop such as occurred in that transition of the fiscal year, it is within the authority of the Purchasing Office to accomplish the procurement in order that the essential functions of government be accomplished.

As noted in the report, there were several contributing factors which resulted in the Office of Procurement having to match expenditures with appropriate fiscal year for a considerable number of purchases with fiscal year budget. Without enumerating all the details, there was the misunderstanding surrounding the availability of Cal Trans funding, the desirability for purposes of the general welfare to accomplish purchases relative to improvements for State hospitals with the funding having been made available under tight time constraints, and a similar desirability under similar circumstances to make purchases relating to the Federal Title II public works employment projects. It is appropriate to note that the described factors existed in addition to the substantial pressures which seem to typically surround year-end closing purchases.

Inasmuch as the report indicates that there is significant question as to the legal authority of this Department to process purchase orders in the manner that we did, we have no objection to the recommendation to obtain legislation that clarifies this matter and eliminates the doubt.

12. The Chief of Procurement control fiscal year-end workload by more strictly enforcing the applicable State Administrative Manual provisions.

Every effort will be made to balance workload within the office

12. (continued)

as well as steps taken to gain assistance from the departments we service. A State Administrative Manual change (attached) has been initiated requiring submission of purchase estimates for equipment prior to April 1 (one month earlier than other purchase estimates). This will greatly enhance our ability to complete all purchase transactions by the end of the fiscal year.

We will continue to review our operations in an effort to control year-end workload, however, it should be recognized that circumstance outside the control of the Department (i.e., Legislative appropriation approved after Purchase Estimate cut off dates) may necessitate acceptance of purchase estimates late in the fiscal year in future years. Perhaps the proposal for legislative action to grant authority to the Board of Control to designate the appropriation to which a purchase is charged can alleviate future problems in this area.

13. Establish specific completion dates and priorities for implementing the purchasing phases of SLAMM, particularly management report deficiencies, refinement of bid lists and collection and submission of contract and delegation order data;

Specific completion dates and priorities will be established in accordance with the above recommendation. Most of the concerns noted have been completed except submission of contract order data. A major effort will be directed at improving the quality of contract data submitted by ordering agencies, primarily thru additional follow-up training with agency personnel.

14. Reinstruct buyers to check SLAMM bid lists for known sources of supply until system improvements are implemented;

This recommendation is being adopted and appropriate revision, re-stating this policy, will be made to the Buyer's Manual.

15. Propose to the State Controller that he consider accumulating contract and departmental purchasing delegation data for the Office of Procurement;

A written request will be made to the State Controller's Office to discuss the accumulation of contract and delegation data within their proposed system.

16. Schedule periodic SLAMM training sessions for agency purchasing personnel.

State agencies will be contacted and a schedule developed to conduct follow-up SLAMM training during this coming fiscal year.

17. We recommend that the Department of General Services set its prices based on cost rather than market value.

AND

17. (continued)

AND
18.

We further recommend that the Office of Procurement decrease its charges for purchasing services and correspondingly increase Central Stores' prices as necessary to recover needed cash in accordance with its working capital plan.

This report states that the Materials Services Unit (formerly Central Stores) charges prices which do not recover all costs and that this revenue recovery "burden" has been placed on the Purchasing Unit. Contrary to the inference in this recommendation, Materials Services fully recovers all of its costs and in fact has contributed \$2.5 million to its accumulated surplus since 1972 as shown in the table below.

	June 30, 1972 Central Stores	March 31, 1979 Central Stores	Difference
Cash	-3481361	-2512897	968464
A/R	1667523	1938060	270537
A/P	791055	1967857	-1176802
	<u>-2604893</u>	<u>-2542694</u>	<u>+ 62199</u>
Inventories	2626081	4978215	+2352134
Net Equipment	172507	166446	- 6061
	<u>193695</u>	<u>2601967</u>	<u>2408272</u>
Accumulated Surplus	- 409801	2133341	2543142
Donated Surplus	134870	-0-	- 134870
W/C Advance	468626	468626	-0-
	<u>193695</u>	<u>2601967</u>	<u>+2408272</u>

The reason why the Materials Services Unit must rely on client cash advances is twofold. First, the unit had an inventory level of \$2.6 million in 1972 that was never capitalized. Secondly, any contribution to surplus must first be applied to fund program/inventory growth. Thus, as long as the Materials Services Unit's program rapidly grows due to consolidation efforts and inflation, the rates charged will only be able to marginally begin offsetting the original inventory. The unit is planning to include a surcharge in its 1979-80 and 1980-81 rates which will fund any inventory increase as well as offset some of the existing cash deficit. To require clients to fund the unit's entire needs in a shorter time period is impractical. In the private sector, companies have the option of obtaining loans or selling bonds for capitalization purposes. The Department of General Services believes that client cash advances is the most practical solution.

In conclusion, the Department of General Services does calculate all of its rates on the basis of expenses not "market value".

17. & 18. (continued)

The amount of service or product ordered by client agencies at the rate offered by each unit is an indication of the value of the product or service as perceived by client agencies.

19. In the event these actions exempt certain Stores' items from competition, we recommend that the Office of Procurement examine alternative methods such as purchasing these items directly or contracting for them.

The actions suggested under this recommendation have been in effect for a period of several years. The Office of Procurement has a continuing program for review of items distributed through the Stores' program to determine if it remains cost effective for a product or group of products to be distributed through the program. When it is determined that it is no longer cost effective to procure an item through the Stores' program, alternate methods of securing delivery of the product to the customer agencies are explored. The Office of Procurement may establish a contract for direct delivery, require agencies to submit purchase estimates requesting the material, issue a delegation for direct purchase of the item, etc. The Office of Procurement will continue to review products to insure that distributing them through the Stores' program is cost effective.

ATTACHMENT FOR RECOMMENDATION 12
 SUBMISSION PROCEDURE FOR PURCHASE
 ESTIMATES AND REQUISITIONS (Revised 5/79)

3553

Purchase estimates involving EOP equipment and supplies not exempted under SAM, Section 3558.11 shall be submitted directly to the Data Processing Management Office, Department of Finance. All other purchase estimates which require budget staff approval under the terms of SAM, Section 3558.1 should be submitted directly to the budget staff, Department of Finance. Purchase estimates not requiring review by the Department of Finance should be submitted directly to the Office of Procurement.

Purchase estimates chargeable to current year expiring appropriations for equipment items (as defined in SAM, Section 8552.3) with an estimated cost exceeding \$5,000, must be received by the Office of Procurement by April 1. All other purchase estimates chargeable to current year expiring appropriations must be received before May 1. Purchase estimates lacking required approvals by other State departments or divisions of the Department of General Services will be returned to the ordering agency. Such purchase estimates must be received by the reviewing agencies as follows:

<u>Department of General Services</u>	<u>Due Date in Approving Division (Prior workday if the date falls on a weekend)</u>	
	<u>Equipment Over \$5,000</u>	<u>All Other Purchase Estimates</u>
Communications Division	March 15	April 15
Fleet Administration Division	March 1	April 1
Office of State Printing	March 15	April 15
Records Management Division	March 15	April 15
Space Management Division	March 15	April 15
Office Services Division	March 15	April 15
<u>Department of Finance</u>		
Data Processing Management Office	March 15	April 15
State Fire Marshall	March 19	April 19

A purchase estimate received after May 1, may be processed if there is a full and adequate explanation for the late submission approved by the department's chief administrative officer, or chief fiscal officer authorized by him/her, and it is either:

1. Required by an emergency involving public health, welfare, or safety, or
2. Funded by appropriations expiring June 30, or earlier which were not available before April 15.

Each purchase estimate should indicate that the funding is either from a "continuing appropriation" or an "expiring appropriation".

Refer to Board of Control Rule 610 concerning purchases in one fiscal year for use in the subsequent fiscal year and definition of legal charges against the old and the new fiscal years.

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Refer to Board of Control Rule 610 concerning purchases in one fiscal year for use in the subsequent fiscal year and definition of legal charges against the old and the new fiscal years.

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BION M. GREGORY

Sacramento, California
January 8, 1979

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Mr. John H. Williams, Auditor General
Office of the Auditor General
925 L Street, Suite 750
Sacramento, CA 95814

State Purchase Orders - #16626

Dear Mr. Williams:

You have asked certain questions regarding procedures of the Office of Procurement of the Department of General Services regarding purchase orders. Purchase orders are processed as follows:

1. A formal requisition, called a purchase estimate, is submitted to the Office of Procurement by a state agency.
2. The Office of Procurement solicits price quotations from vendors.
3. A vendor is selected and a purchase order is prepared and signed by an employee of the Office of Procurement and is usually dated the day of transmission of the purchase order to the vendor.
4. A copy of the purchase order is transmitted by the Office of Procurement to the State Controller and that office charges the amount to the appropriate fund.

You have submitted a purchase order which has June 30, 1978, as the purchase order date; however, the signature of the employee of the Office of Procurement is dated July 28, 1978, and the solicitation of price quotations from the successful vendor is dated July 10, 1978.

QUESTION NO. 1

At what point in the purchase order process are state funds legally obligated?

OPINION NO. 1

State funds are legally obligated upon the date of transmission of the purchase order to the vendor by the state agency.

ANALYSIS NO. 1

Section 16304 of the Government Code provides that an appropriation of state funds shall be available for encumbrance during the period specified therein, or if not otherwise limited by law, for three years after the date upon which it first became available for encumbrance and that an appropriation shall be deemed to be encumbered at the time and to the extent that a valid obligation against the appropriation is created.

Section 1428 of the Civil Code provides that an obligation arises from the contract of the parties or the operation of law. A contract is an agreement to do or not to do a certain thing (Sec. 1549, Civ. C.), and the elements of a contract are parties capable of contracting, their consent, a lawful object, and sufficient cause or consideration (Sec. 1550, Civ. C.). Consent must be free, mutual, and communicated by each of the parties to a contract to each other (Sec. 1565, Civ. C.). The manifestation of mutual assent is usually accomplished through the medium of an offer to the offeree and an acceptance communicated to the offeror (see American Bldg. etc. Co. v. Ind. Ins. Co., 214 Cal. 608). Consent is deemed to be fully communicated between the parties as soon as the party accepting a proposal has put his acceptance in the course of transmission to the proposer (Sec. 1583, Civ. C.; and see State of California v. Agostini, 139 Cal. App. 2d 909, 915).

In the situation in question, the price quotations solicited from vendors by the Office of Procurement can be categorized as requests for bids, and such bids are merely offers to enter into a contract to make a purchase (see A.A.B. Electric, Inc. v. Stevenson Pub. Sch. Dist. No. 303, 491 Pac. 2d 684, 686); and the transmission of a purchase order to a vendor can be categorized as an acceptance of the vendor's offer. In fact, the purchase order form specifically states "your quotation on ... is accepted for the items listed herein."

Accordingly, in our opinion state funds are legally obligated upon the date of transmission of the purchase order to the vendor by the state agency.

QUESTION NO. 2

By backdating purchase orders is the Office of Procurement illegally committing state funds without creating a valid obligation?

OPINION NO. 2

The backdating of a purchase order by the Office of Procurement does not itself invalidate a transaction but can legally only obligate state funds which were available for encumbrance on the date of transmission of the purchase order to a vendor by that state agency.

ANALYSIS NO. 2

Section 1643 of the Civil Code requires a contract to receive an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties, and Section 1653 of the Civil Code provides that words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected.

Thus, courts will give written agreements, if reasonably possible, a construction which will result in their being enforceable contracts (Lawrence v. Shutt, 269 Cal. App. 2d 749, 761), and if necessary to carry out the intention of a contract, will transpose, reject, or supply words to make its meaning more clear (Heidlebaugh v. Miller, 126 Cal. App. 2d 35, 38).


In the circumstances in question, we think that the backdated purchase order date does not by itself affect the validity of the contract. While we have no information regarding the availability of funds on the date on which a valid obligation was created, it is clear that the backdated purchase order date cannot control the disbursement of any funds which were not available on the actual date that the valid obligation was created.

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Therefore, in our opinion, the backdating of a purchase order by the Office of Procurement does not by itself invalidate a transaction but can legally only obligate state funds which were available for encumbrance on the date of transmission of the purchase order to a vendor by that state agency.

Very truly yours,

Bion M. Gregory
Legislative Counsel

By 
Gerald Ross Adams
Deputy Legislative Counsel

GRA:pcu

cc: Honorable Richard Robinson, Chairman
Joint Legislative Audit Committee

Office of the Auditor General

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
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