

California State Auditor

B U R E A U O F S T A T E A U D I T S

Los Angeles County:

**Departments Can Improve Purchasing
and Warehousing Practices**



November 1997
97018.1

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CALIFORNIA STATE AUDITOR

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November 6, 1997

97018.1

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by the California Government Code, Section 30605, the Bureau of State Audits presents its audit report concerning Los Angeles County's (county) purchasing and warehousing practices. This report concludes that the county needs more comprehensive purchasing information to enable it to analyze departmental purchasing patterns and identify areas where it can consolidate purchases of standardized commodities. Additionally, the county needs to resolve issues related to a contract that its Department of Health Services intends to enter into with a group purchasing organization. The county also incurs significant warehousing and inventory costs because of poor procedures for managing its inventory. Finally, county departments are not always managing purchases carefully and in some cases are circumventing county purchasing policies.

Respectfully submitted,

A handwritten signature in black ink that reads "Kurt R. Sjoberg".

KURT R. SJOBERG
State Auditor

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Summary




Audit Highlights . . .

Our review of Los Angeles County's purchasing and warehousing practices reveals that it:

- Needs comprehensive purchasing information to further consolidate purchases and take advantage of volume discounts;*
- Needs to resolve significant issues before the county's Department of Health Services contracts with a group purchasing organization for drugs and medical supplies; and*
- Incurs significant warehousing and inventory costs because of inadequate inventory management procedures and failure to use more cost-effective distribution systems.*

Further, departments do not always manage purchases carefully and are circumventing county purchasing policies.



Results in Brief

Los Angeles County (county), which has experienced serious budget shortfalls since fiscal year 1991-92, could reduce its spending by improving its inventory management and warehousing systems. During this review, which is one of an ongoing series of audits required by the California Government Code, Section 30605, we found that the county does not have access to sufficient information that would allow it to consolidate further its purchases and take advantage of volume discounts. In addition, county departments could manage their inventory and warehouses more effectively, and they have not consistently used cost-saving direct deliveries from vendors to users. Further, some departments are not managing purchases carefully and are circumventing county purchasing policies. For some purchase orders we reviewed, vendors received late payments, departments split purchase orders (a practice that results in higher administrative costs for the county), and departments exceeded their delegated purchasing authority.

Our audit focused on the county's purchasing and contracting practices and revealed the following areas needing improvement:

- Because it lacks comprehensive purchasing information, the county cannot analyze purchasing patterns at all departments, identify areas in which it can consolidate purchases, or identify commodities that the county could standardize for the purposes of cost savings.
- The county has not yet resolved issues related to a group purchasing contract that its Department of Health Services (health services) is anxious to complete. Although health services is working toward reducing the cost of medical supplies by developing a contract with a purchasing organization, it has not yet consulted its medical staff about future limitations in the selection of drugs and supplies, and the county has not analyzed the contract's effect on costs to other departments.

- As the county's purchasing agent, the Internal Services Department (ISD) is not functioning as effectively as possible because its staff spends time processing purchasing requisitions that departments could handle themselves if the county delegated greater purchasing authority to the departments.

Additionally, we evaluated whether the county has responded to a countywide warehousing review private consultants performed in August 1996. To assess this, we reviewed the warehouse operations at the Los Angeles County Fire Department (fire department), the Department of Public Social Services (social services), the Probation Department (probation department), and the Department of Public Works (public works). Our evaluation disclosed the following conditions:

- In general, the county has not yet taken significant steps to address the recommendations in the consultant's report.
- The county continues to incur significant, unnecessary warehousing and inventory carrying costs because of inadequate management procedures and a failure to use existing, cost-effective distribution systems.
- The four departments we visited cannot manage inventory effectively because the computerized systems that generate materials management information do not routinely produce basic performance measures.
- The inventory management systems at three of the four departments do not fully integrate the materials management, purchasing, and accounting functions. Consequently, the departments duplicate effort, resulting in higher costs.
- The departments we visited do not regularly calculate, track, or report the cost and performance data for their warehouses.

Finally, to determine if departments comply with county purchasing requirements, we examined purchase orders and contracts at the fire department, social services, the probation department, and public works. During our review, we noted these weaknesses in the ways departments have managed purchases and in departments' compliance with county policies:

- The fire department did not obtain the necessary approval before allowing two consultants to incur significant costs on its behalf.
- Because public works did not properly manage two of five purchase orders we reviewed, the vendors received late payments.
- In one instance, the fire department circumvented the contracting authority given to it by the county's board of supervisors.
- The probation department and social services exceeded the purchasing authority given to them by the ISD, without obtaining ISD approval, as required.
- The probation department, social services, and the fire department split purchase orders and thus bypassed the county's purchasing policies.

Recommendations

To improve its management of the purchasing process, the county should take these actions:

- Continue its efforts to implement a new purchasing management information system that will track the county's purchases in detail.
- Perform more analyses before health services enters its contract with the group purchasing organization that would provide drugs and medical supplies. These analyses should include an assessment of the contract's effect on the county as a whole.
- Through the ISD, increase the level of purchasing authority it delegates to departments.

To reduce its costs for inventory management and warehousing, the county should do the following:

- Reduce inventory levels and then combine storage facilities where possible. To do so, the county should regularly evaluate the turnover rates for all commodities and then remove obsolete or excess items from stock.

- Take advantage of existing next-day delivery contracts as well as those that include direct delivery to users. In addition, the county should expand its use of such contracts to include additional commodities.
- Enhance departments' materials management information systems.

To use county funds as economically as possible, departments should manage purchases prudently. Specifically, each department should take the following steps:

- Obtain the required approvals before allowing consultants to perform work on its behalf.
- Ensure that its staff completes purchase orders accurately and promptly.

Agency Comments

In its response to our audit, the county generally agreed with our recommendations. In fact, the ISD and the auditor-controller are evaluating a management information system that will capture comprehensive purchasing data and automate much of the purchasing process. Also, the county board of supervisors has directed its Quality and Productivity Commission to make recommendations to improve the county's inventory and warehousing practices. Finally, the auditor-controller has recently expanded its departmental compliance reviews to ensure compliance with purchasing and contracting policies.

Introduction

Background

Established in 1850, Los Angeles County (county) is one of California's 58 counties. Located on the State's southern coast, it covers 4,083 square miles and had a population of 9.5 million in 1996. The county's population exceeds that of 42 states and is the highest of any county in the nation.

Under provisions of its charter, its ordinances, and state and federal mandates, the county is responsible for providing public welfare, health, and safety services and for maintaining public records. It provides health services through a network of county hospitals, comprehensive health centers, and clinics. For its unincorporated areas, the county supplies municipal services and operates recreational and cultural facilities. The county also furnishes such services as law enforcement and public works to its cities, which reimburse the county for the costs of those services.

Elected to four-year alternating terms, the five members of its board of supervisors govern the county and appoint all department heads except the assessor, sheriff, and district attorney, who are elected officials. The county operates on a fiscal year that runs from July 1 through June 30.

The county's Internal Services Department (ISD) supports county departments in their delivery of public services. Established in January 1989, the ISD was a consolidation of the county's Data Processing, Facilities Management, and Purchasing and Stores departments. In fiscal year 1996-97, the ISD consisted of seven programs, including Purchasing and Central Services.

Providing centralized purchasing services for the county, the ISD solicits bids from vendors and establishes agreements with vendors that can supply goods and services to the county. In addition, the ISD offers guidance and training on procurement matters to county departments.

During fiscal year 1996-97, the county spent approximately \$2.4 billion for goods and services, including \$627 million acquired through purchase orders. The Los Angeles County Code, Section 2.81.800, established the ISD as the purchasing agent for the county. In that role, the ISD obtains or makes available goods and services costing less than \$100,000. One

way the ISD fulfills this responsibility is by identifying opportunities to bundle purchases of certain commodities into master agreements and locking in prices with vendors. Master agreements allow the county to reduce the number of steps in the purchasing process and to use the county's buying power to obtain favorable prices.

Scope and Methodology

The California Government Code, Section 30605, mandates the Bureau of State Audits (bureau) to review the county's fiscal condition as well as determine the past conditions and actions that contributed to the budget shortfalls in recent years. In addition, Section 30605 directs the bureau to perform four semiannual reviews of the county's finances. To date, two of these reviews have been completed. Section 30605 further states that our reviews may include recommendations for improving the economy and effectiveness of the county's operations.

Because we have seen instances of other government agencies demonstrating ineffective purchasing methods, we decided to conduct a performance audit of the county's purchasing, warehousing, and inventory management practices. We then selected the following five departments for review: the ISD, designated as the county's purchasing agent; the Department of Public Social Services (social services); the Probation Department (probation department); the Department of Public Works (public works); and the Los Angeles County Fire Department (fire department). As previously stated, the ISD provides centralized purchasing services to the county. We selected the remaining departments because they are four of the county's larger departments based on annual expenditures.

To evaluate the efficiency and effectiveness of the county's purchasing operations, we interviewed county and departmental administrators, and we reviewed relevant purchasing regulations, policies and procedures, both countywide and by department. In addition, we analyzed central functions currently performed by the ISD, such as the processing of purchase requisitions, to determine whether county departments could accomplish the functions more effectively. We also reviewed the County Accounting and Payment System (CAPS) and the ISD's Document Workflow Management System.

Further, we examined the county's warehousing and inventory management procedures. Our audit included determining the status of issues, findings, and recommendations included

in a consultant's countywide warehousing study released in August 1996. Specifically, we assessed whether the major findings in this report still exist and whether the county has addressed the report's recommendations. Additionally, we interviewed procurement and materials management administrators and staff at each department and toured the central warehouses at the probation department, social services, the fire department, and public works. We also toured the probation department's Juvenile Hall warehouse and public works' auto supply warehouse. We reviewed a nonstatistical sample of inventory items from each warehouse and determined the turnover ratio for these items. Finally, we obtained the services of a consultant to help us analyze warehousing and inventory management standards and practices.

To evaluate the departments' compliance with the county's purchasing policies and procedures and the effectiveness of the procurement process, we initially examined five purchase orders and five contracts at each of the four departments. Our review included determining whether purchase orders and contracts included appropriate language and provisions, supporting documentation, and approvals. Further, we evaluated the purchase orders and contracts to verify whether the departments had properly planned and monitored purchases. During our review at the fire department, social services, and the probation department, we noted instances of noncompliance in transactions outside of our original sample. As a result, we expanded our review at these three departments.

Because the following chapters include numerous terms that require explanation, we list their definitions on the following page.

Purchasing Terms Los Angeles County Uses

Master agreement – an agreement between the county and a small group of specified vendors in which the ISD has negotiated prices for all of the products the vendors carry with the exception of specific items that the county has elected to exclude from the agreement.

General agreement – an agreement between the county and a specific vendor in which the ISD has negotiated prices for specified items.

Agreement vendor – a vendor with which the county has established an agreement.

Nonagreement vendor – a vendor with which the county has not established an agreement.

Blanket purchase order – a document that conveys to departments some purchasing authority, usually based on a department's estimated annual requirement, for a specific type of commodity.

Subpurchase order – a purchase order that departments use to charge individual purchases against blanket purchase orders.

Agreement blanket purchase order – a purchase order that allows a county department to buy, up to the total amount named on the blanket purchase order, any goods and services for which an agreement exists.

Nonagreement blanket purchase order – a purchase order that permits a county department to buy, without the approval of the ISD, goods and services that cost up to \$5,000 and for which there is no agreement.

Direct purchase order – a purchase order that allows county departments to make one-time purchases of goods and services over \$5,000 when no agreement exists. Departments must obtain ISD approval for these purchases.

Delegated contracting authority – the level of authority to purchase contract services given to a county department.

Delegated purchasing authority – the level of authority to purchase goods and services given to a county department.

Chapter 1

The County Should Acquire More Information About the Goods and Services It Purchases

Chapter Summary

Los Angeles County (county) needs to continue efforts to lower its costs for goods and services by simplifying the purchasing process and by negotiating lower prices for items its departments use. To accomplish this, the county should see that the information for analyzing countywide purchasing patterns is available to its Internal Services Department (ISD), which is the central procurer of goods and services for the county. County departments may have spent as much as \$223 million for goods and services not listed on vendor agreements because the ISD did not have enough information to identify opportunities to consolidate these purchases. By grouping its purchases and taking advantage of volume discounts, the county may be able to lower its costs and reduce the steps required for departments to buy goods and services.

Currently, the county's Department of Health Services (health services) plans to pool its purchases with other buyers by contracting with a group purchasing organization (GPO). Although the county needs to address significant issues before it enters into this contract, the plan shows promise and may enable health services to buy medical, dental, and laboratory supplies in a more cost-effective way.

Further, the ISD should focus less effort on the day-to-day processing of purchasing transactions so that it can better concentrate on developing procurement strategies to help reduce county costs. Such strategies could include analyzing purchasing information, providing training to departments on purchasing policies, and developing purchasing methodologies that would facilitate consolidating the county's warehouses, a topic we cover in Chapter 2. To reduce its transaction-processing workload, the ISD could reduce the use of direct purchase orders for expenditures up to \$15,000, and it could process blanket purchase orders more efficiently.

County departments
spent approximately
\$2.4 billion acquiring
goods and services during
fiscal year 1996-97.

Background

For \$627 million of the \$2.4 billion it spent on goods and services, the county used purchase orders to obtain needed services and goods. Approximately \$111 million of the \$627 million related to direct purchase orders. Through its ISD, the county spent the remaining \$516 million on items and services covered by agreement and nonagreement blanket purchase orders.

After the county closed its central warehouse in June 1996, the ISD began an effort to negotiate more master agreements that county departments could use to purchase commodities previously stocked in the warehouse. The ISD developed five new master agreements for office supplies, food, janitorial services, restaurant supplies, and printing services.

A master agreement can result from the ISD combining multiple agreements with the same vendor or a group of vendors that will supply a "shopping basket" of related items. For example, the ISD combined multiple agreements to purchase individual items, such as pens and pencils, into a master agreement for office supplies from Office Depot, Corporate Express, and BT Office Products. The ISD can also establish a master agreement if it identifies a countywide need for a specific service or group of commodities, such as landscaping services or janitorial supplies.

When the ISD identifies an opportunity to establish a master agreement, it can either negotiate prices for specified goods or services, such as file cabinets or security services, or it can negotiate the price for an entire shopping basket of related items, such as office supplies. The ISD negotiates the prices through a competitive bidding process by sending out bid packages to vendors. A bid package contains the specifications for an item or group of items, the deadline for submitting the bid to the ISD, and other instructions to the vendors. Once the ISD has selected the best vendor or group of vendors and awarded an agreement, a department can ask the ISD to establish an agreement blanket purchase order, which generally allows the department to purchase up to a specified dollar amount from the vendor without further vendor solicitation or additional ISD approval.

However, some master agreements, such as the one for personal computers, require departments to solicit bids, but only from the group of vendors named in the master agreement. These agreements encourage competition for commodities that are subject to frequent price fluctuations.

***The County's Department of
Health Services Plans To Reduce Its
Costs of Purchasing Medical Goods***



—◆—
*Health services is
working to reduce
pharmaceutical and
medical supply costs by
contracting with a group
purchasing organization.*
—◆—

In addition to the ISD's recent efforts to reduce purchasing costs by establishing additional master agreements, health services and the ISD are working toward reducing costs for pharmaceuticals and medical supplies by contracting with a group purchasing organization (GPO). Generally, a GPO is a private organization in which buyers with similar purchasing interests form alliances, increasing the volume of their purchasing requirements to negotiate lower prices with suppliers. The DHS intends to join other public and private hospitals that currently have membership in a GPO. Within some GPOs, members agree to purchase a specified percentage of their supplies from certain vendors. In return, the suppliers agree to sell their goods and services to the GPO members for a low price. Theoretically, as the GPO's membership increases, the aggregate volume of needed goods and services increases, resulting in deeper discounts for members.

Health services plans to reduce its costs by contracting with a GPO, thus consolidating its purchases and limiting the assortment of pharmaceuticals and medical supplies it buys. We believe that health services deserves credit for taking steps to obtain volume discounts. However, we have some concerns about health services' plan to implement the GPO contract before the county has sufficiently analyzed the contract requirements.

***The County Needs To Address
Important Issues Before It
Signs the GPO Contract***

According to our discussions with its staff, health services believes that it will lose opportunities for cost reductions unless it implements the GPO contract quickly. However, the ISD believes that the county needs to perform more analyses before entering into this contract, and it has expressed its concerns to health services. For example, the ISD believes that the county needs to examine fully how implementing the new contract would affect the county as a whole. We believe that the ISD's concerns are reasonable, and we discuss a few of its concerns below.


Other county departments may pay higher prices for some items if health services contracts with a group purchasing organization.



One of the main issues that the county needs to resolve is the possibility that departments outside health services' GPO contract will need to pay more for medical and other goods. Currently, health services has at least 500 agreements with vendors that supply the county's pharmaceuticals and medical supplies, in addition to agreements it uses for nonmedical items, such as paper products. If health services stops doing business with these current suppliers, other departments may have to pay higher prices for some items. For example, the Los Angeles County Sheriff's Department (sheriff's department) and the fire department currently purchase from some of the same vendors that provide medical supplies to health services. If health services pulls out of the county's original agreements, the volume level on which the vendors have based their prices will decrease, and the vendors may raise prices for medical supplies the sheriff and fire departments require. The county needs to evaluate this possibility and determine whether departments in addition to health services can join the GPO.

Further, the county needs to involve representatives of health service's medical staff in the decision to purchase medical, dental, and laboratory supplies through a GPO. The new contract will require standardization (use of the same brands) of the pharmaceuticals and medical supplies now available to county physicians, nurses, and lab technicians. Currently, health services' purchases of pharmaceuticals are largely standardized. Conversely, its purchases of medical supplies are not standardized. Purchases of these supplies are based on clinician preference. In addition, implementation of the GPO contract will limit the number of vendors health services can purchase from, which was more than 1,700 in fiscal year 1996-97. According to the chief of the ISD's Purchasing and Central Services Division, in the past the ISD has tried unsuccessfully to encourage health services to standardize its medical supplies purchases. Because some providers of the county's medical services may disagree with the decision to limit the selection of medical supplies available to patients, the county needs to invite early discussion of these changes to anticipate problems the limitations may create. Health services intends to involve county medical staff once it begins implementing the GPO contract.

Finally, because the GPO could penalize health services if it does not purchase its quota of supplies, the county needs to determine its ability to meet the contract's requirements. According to the GPO's policy manuals, the contract terms require health services to purchase all of its pharmaceuticals and at least 80 percent of its medical supplies from GPO suppliers. If health services' medical staff resists the contract's terms, the county needs to know the consequences of its

inability to meet the quotas set by the GPO. For example, the GPO may terminate the contract, which would require the county to find alternative ways to purchase its pharmaceuticals and medical supplies.

The ISD Needs Better Data on Purchasing Patterns


With more detailed data on purchasing patterns, the ISD could more effectively identify and analyze trends and assist departments with budgeting decisions.

Although the ISD is moving toward reducing purchasing costs by establishing master agreements and working with health services on its GPO contract, the ISD needs improved management data so that it can analyze the county's purchases more thoroughly. Under the ISD's current organizational structure, information is available for county buyers to make informed purchasing decisions about the individual commodities or groups of commodities they are assigned to buy. However, the ISD lacks detailed information on the purchasing patterns of departments around the county. With such data, the ISD could effectively analyze these trends, monitor departmental purchases, and assist departments with budgeting decisions.


By analyzing purchasing patterns, the ISD could identify areas in which it can further consolidate purchases to take advantage of volume discounts. In addition, the ISD could identify additional opportunities to increase the efficiency of the county's purchasing process. For example, for groups of related commodities that multiple departments currently buy outside of agreements or purchase under agreements for individual commodities, the ISD could establish master agreements like the ones departments currently use to acquire office supplies.

Also, with usage information from departments throughout the county, the ISD and the Auditor-Controller's Office can more easily monitor departmental purchases by analyzing the purchasing needs of like commodities for departments of similar size. For example, two departments of similar size may purchase different amounts of janitorial supplies or office supplies. Countywide purchasing data would allow the ISD to evaluate this discrepancy.


Currently, the county's ISD employs 34 buyers, each processing purchases that exceed departments' delegated authority when no agreement exists. Each buyer is responsible for certain commodity types. For example, one buyer purchases copy machines while another buyer acquires plumbing supplies. The buyers are also responsible for determining how to purchase

their assigned commodities at the lowest prices. For example, buyers negotiate prices and establish agreements with vendors that can provide the county's goods and services.

The ISD's organizational structure allows buyers to develop purchasing expertise related to their specific commodities and to make informed purchasing decisions. For example, over time, the buyer for office furniture gains a historical perspective about suppliers and prices for office chairs because he or she processes all purchase requests for that commodity. In addition, the buyer can determine whether the county can obtain a certain type of chair at a reduced price by combining the purchase requests from two or more county departments. Finally, a buyer who is familiar with suppliers that do not have agreements with the county can assess whether creating a new agreement will result in a lower price for a commodity, whether the county can add a commodity to an existing agreement because the county buys the item routinely, or if the commodity is a special order item only.



The county may be missing volume discount opportunities because its accounting system does not provide usage data or descriptions of commodities purchased.



Although ISD buyers have sufficient information related to their assigned commodities, ISD management does not have comprehensive historical information about the commodities purchased by the county as a whole so that the ISD can find ways to reduce costs. The county's current accounting information system, the County Accounting and Payment System (CAPS), was not designed to provide usage data or descriptions of commodities bought by all departments so that the ISD can analyze and monitor purchasing trends effectively. The CAPS provides only general descriptions for groups of commodities and services such as "office expense—other," and "special departmental expense." In addition, the county may be missing opportunities to obtain better pricing through volume discounts because the CAPS does not supply data on the quantities of items, such as envelopes or tires, that all departments use.

The ISD Is Trying To Improve the County's Purchasing System

The ISD acknowledges that it needs better information on purchasing patterns for all county departments, and it is working toward improving the county's current purchasing system. Specifically, the ISD is developing a plan to install a new information system that can capture data on countywide purchasing trends and improve the county's ability to obtain lower prices. The ISD also foresees benefits from additional

technologies it plans to implement, such as automated requisitioning and ordering, as well as computerized access to agreement listings and vendor catalogs.

According to the chief of the ISD's Purchasing and Central Services Division, this new management information system will compile purchasing data from all county departments and allow the ISD to analyze easily purchasing trends, such as unusual fluctuations in departments' requests for specific commodities or commodity groups. The system's usage data should also allow the ISD to identify areas in which the county could standardize its purchases by establishing additional master agreements because the ISD will be able to quantify the volume required for a specific commodity or group of related commodities. Finally, the new system will provide useful information to departments when they develop their annual budgets for supplies and services.

The ISD Should Give Greater Purchasing Authority to County Departments

◆
Increasing the purchasing authority delegated to county departments would reduce the direct purchase orders reviewed by the ISD by 50 percent.

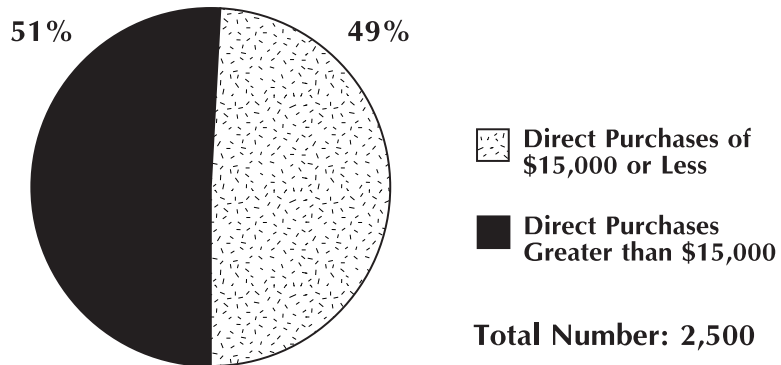
The ISD could decrease its workload and spend more time establishing cost-effective master agreements if it were to give greater responsibility for purchasing decisions to county departments. In addition, the ISD could increase the efficiency of the purchasing process by eliminating steps required for purchases between \$5,000 and \$15,000. Currently, the ISD delegates to departments the authority to purchase goods and services that are not under agreement and that cost \$5,000 or less. For nonagreement purchases over \$5,000 (direct purchases), departments must obtain ISD approval.

The ISD's purchasing procedures require its buyers to solicit bids for nonagreement purchases over \$5,000. County departments submit requisitions that contain descriptions of the needed goods or services; these documents may also include a list of potential vendors. The ISD first reviews each requisition to ensure that the goods or services are not available under an existing agreement and then solicits bids from vendors by telephone or by letter, or it mails bid packages. From the bid responses, the ISD selects the best vendor and verifies the availability of funds for the purchase. Finally, the ISD issues an approved purchase order to the requisitioning department.

During fiscal year 1996-97, the ISD processed 2,500 direct purchase orders totaling approximately \$111 million. Of these, 1,231, or 49 percent, applied to purchases of \$15,000 or less, as shown in Figure 1.

Figure 1

Number of Direct Purchase Orders the ISD Processed for Fiscal Year 1996-97

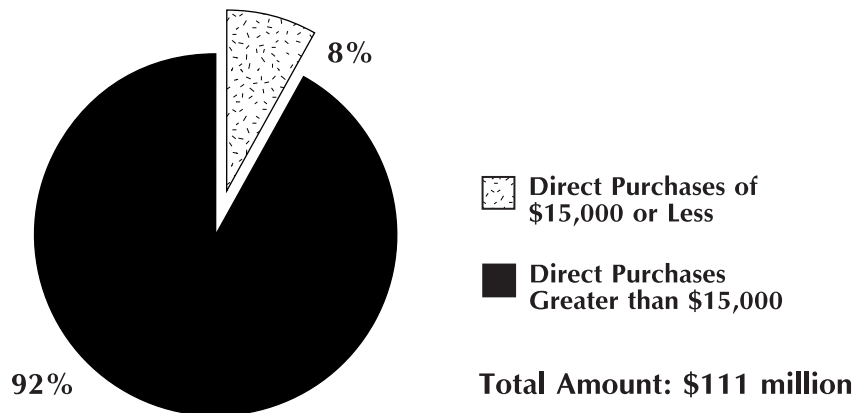



However, as shown in Figure 2 below, direct purchase orders for less than \$15,000 accounted for only \$9 million, or 8 percent, of the total dollars spent for direct purchases.

In our view, the ISD could expand the purchasing authority delegated to the departments and allow them to process direct purchase orders up to \$15,000 rather than \$5,000. The county would not incur much additional risk of imprudent purchases because, even though the ISD would review approximately 1,200 fewer purchases per year, the dollar value of the purchases it would continue to review would decrease by only 8 percent.


Figure 2

Dollar Value of Direct Purchase Orders the ISD Processed for Fiscal Year 1996-97





Departments would provide the same oversight on purchases of less than \$15,000 that they currently give to purchases of \$5,000 or less.



Though the county benefits from the ISD's independent review of direct purchases, by shifting the responsibility and accountability for direct purchases less than \$15,000 to departments, the county could still be sure that it purchases in a cost-effective manner. The departments will be responsible for providing the same oversight for these purchases as the departments' supervisors and procurement specialists currently provide for nonagreement purchases that are \$5,000 or less.

Increasing the level of purchasing authority delegated to county departments will reduce by half the direct purchase orders the ISD processes, thus allowing the ISD to focus on cost cutting. Conversely, according to the figures for direct purchase orders the ISD processed for fiscal year 1996-97, the ISD will continue to analyze and process 92 percent of the direct purchase orders' total dollar value. In addition, by transferring the responsibility for oversight of purchases up to \$15,000 to the departments, the ISD would eliminate the transfer of requisitions from the departments to the ISD, thus increasing the efficiency of the purchasing process.

Our analysis is based on increasing the level of delegated purchasing authority for all departments. However, if the county believes that it is more prudent to increase the level for only those departments that have demonstrated responsible purchasing practices, we believe this approach is reasonable. Additionally, if the increased delegated authority proves successful, the ISD should consider a higher level for low-risk purchases of specific goods.

The County Needs To Streamline the Blanket Purchase Order Process

The county could save time and thus cut costs if it revised the process by which the ISD establishes each blanket purchase order (BPO). For fiscal year 1996-97, county departments submitted approximately 3,000 requisitions to the ISD to establish BPOs. Generally, a BPO specifies the level of spending authority that a department can use to purchase services or commodities. For example, in response to a requisition the county's Department of Parks and Recreation submitted, the ISD may establish a BPO for \$40,000 for bus services to county recreational sites. The department can then use the BPO to purchase these services up to the \$40,000 limit.

Generally, the ISD analyzes a department's requisition to determine if the type of commodity needed is available under an existing agreement, whether it warrants the creation of a new agreement, or if the ISD can add it to an existing agreement.

If it determines that there is a current agreement for the commodities, the ISD establishes a BPO to facilitate the department's use of the agreement. Otherwise, it creates a nonagreement BPO. The ISD also reviews the requisition for completeness, enters the information into its system for tracking the processing of purchase orders, and verifies that sufficient funds are available. The ISD then sends a copy of the BPO to the department.

To complete the procedures for establishing a BPO more efficiently, the ISD could send each department a summary list of its existing BPOs instead of having all departments submit individual BPO requisitions before the beginning of a new fiscal year. Each department could add to, delete from, or otherwise make changes to its list based on its estimated needs for the new fiscal year. For example, a department could give the ISD the information required to establish new BPOs, or it could increase or decrease the value of an existing BPO. The department would then submit its list, including changes, to the ISD. The ISD could review the information and simply update the list from the prior year by entering only the department's changes into its tracking system. This process would save time by eliminating the piecemeal transfer of requisitions and blanket purchase order documents between county departments and the ISD, but it would also retain the ISD's ability to analyze purchasing information.

***The ISD Needs To Give County
Departments More Training
in Purchasing Procedures***


We found that three county departments circumvented county requirements by splitting purchase orders.


As we discuss in Chapter 3 of this report, county departments do not always comply with purchasing policies and procedures. Specific instances of noncompliance occurred at three of the four departments we reviewed. We found that three departments circumvented county purchasing requirements by splitting purchase orders. In addition, two of these departments violated purchasing standards by making purchases that exceeded their delegated authority without obtaining the required approval.

This lack of compliance suggests that departments need training in purchasing procedures and a review of the county policies that require ISD approval of all transactions over a certain threshold. The ISD is responsible for conducting this training. However, although ISD buyers provide guidance to county departments as needed, the ISD conducted only one procurement training class during fiscal year 1996-97.

Since the ISD closed the county's central warehouse in June 1996, it has implemented new methods for departments to obtain the goods they require. When the ISD develops new purchasing policies and procedures, departments may require more training to ensure that they understand county rules.

Conclusion

By combining purchases into master agreements and pooling purchases with other buyers, the county's ISD is working to lower prices and cut costs. However, the ISD needs more detailed information to identify purchasing trends that could lead to further consolidation of county purchases and more favorable prices. Better purchasing information could also assist the county during its budget process. Finally, opportunities exist for the ISD to become less involved in processing direct purchase orders and more involved in finding better ways to manage the acquisition of goods and services.

Recommendations

To develop more cost-effective ways to purchase goods and services for its departments, the county should take the following steps:

- Perform more analyses before health services enters into a contract with a group purchasing organization. These analyses should include the effect of the GPO contract on other departments and on the county as a whole, the reaction of medical staff to standardization of medical supplies, and the consequences of noncompliance with contract requirements.
- Continue its efforts to implement a new purchasing management information system that captures data necessary for monitoring departmental purchases. The county should coordinate its efforts to update information systems so that all departments eventually work on a system that provides countywide procurement data.
- Reduce the number of direct purchase orders the ISD processes by increasing from \$5,000 to \$15,000 the level of department purchasing authority so that the ISD can focus on cost-cutting strategies.

- Streamline the ISD's process for establishing blanket purchase orders by providing departments with a list of their existing blanket purchase orders so that departments can simply make changes to the list.
- Ensure that all of its departments are aware of purchasing policies and procedures by having the ISD focus more effort on training and guidance.

Chapter 2

The County Needs To Improve Its Inventory Management

Chapter Summary


Los Angeles County (county) continues to incur significant unnecessary costs for warehousing and inventory because it has ineffective inventory management practices and has underused existing distribution systems. We reviewed the inventory management practices at the Department of Public Social Services (social services), the Probation Department (probation department), the Department of Public Works (public works), and the Los Angeles County Fire Department (fire department), and found that all four use central warehousing instead of direct delivery. This practice results in the unnecessary storage of excess or obsolete inventory and in increased carrying costs for the county.

In addition, inventory management is inefficient because none of the four departments regularly reports the basic inventory management information of average inventory amounts, warehousing costs, or the rate at which each commodity leaves storage. Also, in three of the four departments, the computerized materials management systems do not share information with the purchasing systems, resulting in duplicate efforts and inefficient use of public resources.


On the other hand, we did find examples at two of the departments and at the ISD where the departments streamlined their inventory, management, and warehousing operations. These department's efforts are helping the county to save money.

Background

Los Angeles County's financial crisis, ongoing since fiscal year 1991-92, prompted the county to search for ways to reduce costs. The county felt its existing warehousing practices presented opportunities to streamline operations and reduce costs. The county's board of supervisors asked the Deloitte and Touche Consulting Group (consultants) to perform a review of the county's warehouse operations. The consultants assessed the county's inventory management, inventory distribution



In August 1996, consultants reported that the county's materials management system was costly and inefficient.




systems, and materials management information systems. In August 1996, they reported that the county's materials management system is costly and inefficient. For example, the consultants estimated that in fiscal year 1995-96, the county spent approximately \$38 million to store inventory at 93 different locations. Consequently, they recommended that the county reduce inventory levels, implement a system of delivering goods directly to users, consolidate and eliminate warehouses, and promote interdepartmental sharing of warehouse supplies and facilities.

In addition, the consultants found that the departments do not recognize the true costs of their warehouse operations. In most cases, the departments account only for direct staffing, maintenance, janitorial, and vehicle costs and for utilities. According to the consultants, the departments should include in the cost of warehouse operations rent, inventory carrying costs, the salaries of procurement staff not directly connected to the warehouse, and distribution costs that are not part of warehouse operations.

The consultants also determined that most departments have little incentive to change their operations or to implement sound inventory management techniques because any savings that such changes produce will not directly benefit the departments. According to the consultants, each department measures performance solely on how well it meets its own materials needs, and this emphasis has, in some cases, led to excessive inventory levels. For example, the annual figures for countywide inventory turnover indicate that items sit in inventory for approximately six months before departments use the items.

The county has not yet taken significant steps to address the weaknesses in its inventory management. In July 1996, the ISD sent a final draft of the consultants' report to five departments and requested comments on implementation. All departments responded; however, no further follow-up occurred until July 1997, when the chief administrative officer sent a memorandum to the county's eight major warehousing departments: the Sheriff's Department, the fire department, the Department of Health Services, the ISD, the probation department, social services, public works, and the Los Angeles County Superior Courts. The chief administrative officer requested a response to each of the consultants' findings or recommendations, any planned or implemented changes, and target dates for full implementation. All eight departments responded, and it appears that the departments generally agree with the findings and will cooperate in countywide efforts to improve their management of inventory and warehouses.

Current Management Practices Are Creating Unnecessary Inventory Costs


The county spends too much on warehousing because of excessive inventory.

Both our audit and the consultants' review revealed that the county spends too much money on warehousing because it maintains excessive inventory. The county has not yet fully developed efficient, effective inventory management procedures that include reducing excess, obsolete stock and carrying costs and also promptly delivering items to users.

In evaluating the county's warehouse operations, the consultants reported significant levels of inactive or rarely issued inventory, such as forms, custom printed materials, and office supplies. They determined that, in some departments, rarely issued and obsolete inventory may constitute as much as one-third of the total.

Similarly, our review disclosed that the county is not managing its inventory efficiently. Specifically, for the inventory items reviewed, we found obsolete or infrequently issued inventory contributing to low inventory turnover. Maintaining excessive amounts of inventory unnecessarily increases inventory carrying costs and also results in an inefficient use of warehouse space. We estimated total inventory carrying costs of approximately \$1.3 million for fiscal year 1996-97 in the central warehouses of the four departments we reviewed.


Each of these four departments maintains a central warehouse where it stores inventory before distributing the goods or making them available for pickup. In maintaining central warehouses, the departments do not always take advantage of vendors' offers to deliver directly to county employees who will use the commodities.

By eliminating excess, obsolete inventory and using available direct delivery, the departments could reduce county costs, increase the efficiency of their materials management staff, and vacate warehouse space, thus permitting possible warehouse consolidation or sharing. The map in the Appendix showing the location of all county warehouse and storage facilities of 1,000 square feet and larger indicates that some facilities are close enough to one another to allow the departments to share costly warehouse space.

Departments Maintain Excessive and Obsolete Inventory

County departments' inefficient inventory management has contributed to low inventory turnover, which we measured using turnover ratio figures. Turnover ratio is a commonly used inventory performance measure that indicates how often an item is pulled from stock for use. For example, a turnover ratio of 1.00 indicates that all of the items in the inventory turned over an average of once during the year. The turnover ratio is the cost of sales divided by inventory, typically the average annual inventory value. For our calculations, we interpreted the cost of sales to be the value of the commodities distributed out of the warehouse. A high turnover ratio suggests that inventory staff is managing stock effectively and frequently pulling the items for use. A low turnover ratio points to idle inventory and possible overstocking and obsolescence. Because none of the departments we reviewed has the reporting capabilities to provide average inventory values by item, we used the inventory values at fiscal year end to determine turnover ratios for sample items.

Although private-sector organizations and county departments are dissimilar in many ways, county departments nonetheless need to manage their inventories in the same way that private businesses do and comparing departmental practices to private industry standards is not unreasonable. According to the consultants, private-sector warehouse operations frequently define inventory as excessive when an item stays in stock for more than one to two months on average. Private businesses usually consider inventory dormant if it remains unissued for over six months.


County departments turn over their inventories less frequently than private industry.

For items we reviewed, inactive or infrequently issued inventory contributed to low inventory turnover. For example, the turnover ratios for forms and office supplies ranged from 0.24 to 1.23, compared to the private industry standard of 3.50. The turnover ratios for our office equipment sample ranged from 0.04 to 0.09; the private industry standard is 3.00. Further, the private industry standard for furniture is 2.20, but the turnover ratios for our furniture sample were lower, ranging from 0.53 to 2.10. Table 2-1 compares, by commodity type, sample inventory turnover ratios for private industry with those for county departments.

Table 2-1

Comparison of Sample Turnover by Commodity Type

Forms and Office Supplies

Department	Number of Items Reviewed	Departmental Turnover Ratio	Private Industry Turnover Ratio
Social Services	11	1.23	3.50
Probation	54	0.24	3.50
Public Works	31	0.42	3.50
Fire	17	0.67	3.50

Furniture

Department	Number of Items Reviewed	Departmental Turnover Ratio	Private Industry Turnover Ratio
Social Services	9	2.10	2.20
Probation	2	0.53	2.20

Office Equipment

Department	Number of Items Reviewed	Departmental Turnover Ratio	Private Industry Turnover Ratio
Social Services	1	0.09	3.00
Probation	3	0.04	3.00

◆
Many of the forms stored by county departments were not used at all during fiscal year 1996-97.

The probation department offers an illustration of how inefficient inventory management can contribute to low inventory turnover. In the probation department's central warehouse we found 110 pieces of computer equipment that this department purchased three to six months before projected installation dates. Although the calculated costs for storing these items are insignificant, stocking this type of equipment for extended periods increases the risk of theft, obsolescence, and damage, and uses warehouse space inefficiently.

In addition to stocking excessive inventory, departments are storing obsolete items. For example, in some warehouses we found a significant number of printed forms with 0.00 annual turnover. We realize that these inventories probably do not occupy a large amount of warehouse space; however, their existence underscores poor inventory management. At the probation department, from a sample of 40 forms, we found 23 (58 percent) with a turnover of 0.00. At public works, from a sample of 16 forms, we found 5 (31 percent) with a turnover

of 0.00. Based on a total sample of 69 forms at the four departments, we found 29 (42 percent) with a turnover of 0.00. In addition, we found 254 typewriters stored in the social services warehouse that had a turnover ratio of 0.09. Social services values these typewriters at \$76,200, which is 47 percent of the total equipment inventory value for social services.

***Excessive and Obsolete Inventory
Is Increasing Carrying Costs***

A negative effect of the departments storing excess or obsolete inventory is increased carrying costs for the county. Carrying costs, expressed as a percentage of the total inventory investment, are those associated with holding inventory. As indicated in Table 2-2, we calculated the carrying cost percentage to be 17 percent and estimated that the annual inventory carrying costs for the four departments we reviewed totaled approximately \$1.3 million. A portion of these carrying costs is attributable to excess or obsolete inventory. Therefore, the county could realize a savings of this portion by reducing the excess or obsolete inventory.

***Table 2-2
Estimated Annual Inventory Carrying Costs***

Department	Average Inventory Value	Carrying Cost Factor	Estimated Annual Inventory Carrying Costs
Social Services	\$2,768,720	17%	\$ 470,682
Probation	444,344	17%	75,538
Public Works	2,534,078	17%	430,793
Fire	1,695,709	17%	288,271
		Total	\$1,265,284

The four components of inventory carrying costs are *obsolescence, interest, spoilage and loss, and storage*. We explain these components below:

- *Obsolescence*—Inventory can become obsolete for a number of reasons, including manufacturers' changes in models or the introduction of new products. Although no one can estimate the need for inventory items with perfect accuracy, a well-managed organization will identify surplus inventory and dispose of it. A general rule of sound warehousing practices is never to hold inventories for which no immediate need exists. The cost of obsolescence naturally varies, but few private companies can hold it to less than 1 percent of inventory value. For purposes of our analysis of carrying costs, we assume the cost of obsolescence to be 3 percent.
- *Interest*—Capital is never so readily available that organizations can use it to invest in inventory at no extra cost. The cost of interest as applied to inventory is the gain that the county would have earned if it had invested the same amount of money in a different manner. If the money is not used to purchase inventory, it could always earn a rate of return at least equal to the interest for the State of California's Pooled Money Investment Account. (For example, the average annual rate for this account for fiscal year 1996-97 was 5.6 percent.) For our purposes, we assume interest costs to be 6 percent.
- *Spoilage and Loss*—Spoilage and loss relates to damage or deterioration due to storage, handling, weather, age, or shrinkage. Spoilage and loss can vary with the type of inventory, the inventory policies, and the facilities for storage and handling. For a public environment, we can presume that spoilage and loss is at least equal to that experienced in private industry. For this analysis, we project costs due to spoilage and loss of 3 percent.
- *Storage*—Storage is the most direct inventory carrying cost. It includes the costs of storage and warehouse space (that is, utilities and maintenance), salaries of warehouse personnel, administrative and other overhead costs, and insurance. Storage costs can vary widely with the type of material stored and the type of storage facilities used. Industry storage costs are typically 5 percent of the value of material stored per year. Therefore, for this analysis, we use storage costs of 5 percent.

—◆—
Social services spends \$13,000 annually to store 254 typewriters, of which only 23 were requisitioned last year.
—◆—

Using the percentages described above, we estimated the carrying costs for inventory at the departments we reviewed to be 17 percent of their average annual inventory value. Although some portion of this percentage can be attributed to excess and obsolete inventory items, we did not perform an in-depth inventory analysis to calculate the total cost of carrying such items. Nonetheless, social services' 254 typewriters valued at \$76,200, and described on page 22, illustrate the high cost of carrying obsolete items. If we estimate carrying costs at 17 percent, social services spends \$13,000 per year to store these typewriters, even though only 23 were requisitioned in fiscal year 1996-97.

Eliminating excess and obsolete inventory would not only decrease carrying costs, but it would vacate warehouse space, enabling departments to consolidate or share storage facilities and thus reduce warehouse costs.

Central Warehousing Increases County Costs

In their report, the consultants criticized the departmental central warehouse system because it contributes to excess inventory and thus results in increased costs. They describe the departments' methods for receiving, storing, and distributing commodities. Some departments maintain a central warehouse, where commodities are stored until they are delivered or picked up. Other departments receive commodities directly from vendors.

The consultants reported that the county's 93 major inventory locations total over 979,000 square feet. According to the consultants' figures, the combined square footage of warehouses for the four departments we evaluated is approximately 26 percent of total county storage space.

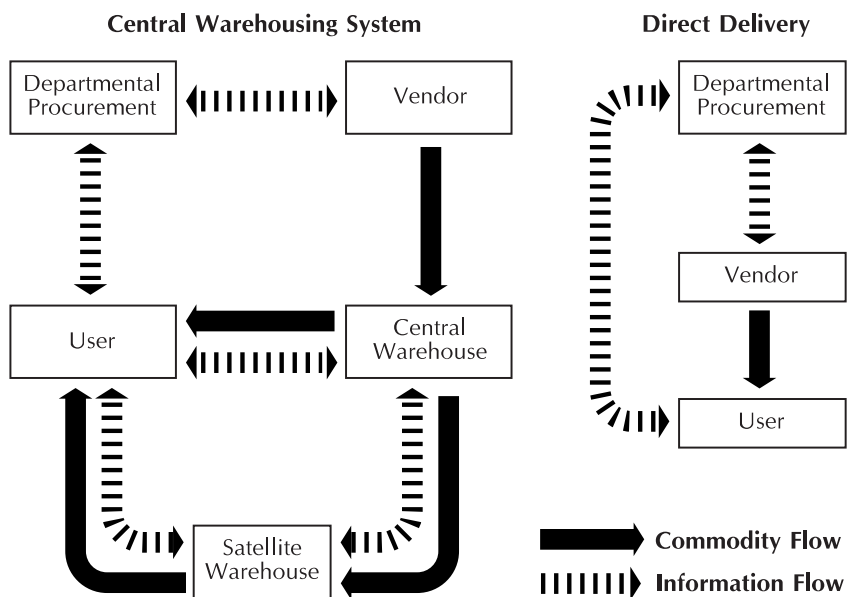
From what we could determine in our review of the warehouses, the county continues to rely on a departmental central warehousing system to receive, store, and distribute commodities. In fact, since the release of the consultants' report in August 1996, the county has not closed any warehouses.

The county could reduce its warehousing costs by using available direct delivery systems.

Social services, the probation department, public works, and the fire department each maintain a central warehouse. The departmental central warehouses receive, store, and then distribute commodities to users or satellite warehouses. The departmental central warehouses may also keep the items until users pick them up. In the meantime, departments incur direct, facility, vehicle, and other distribution costs, and inventory carrying costs.

In contrast, the county could reduce the departmental central warehouses' costs and increase materials management efficiency by using direct delivery from vendors. The county currently has direct delivery agreements for food, medical, janitorial and kitchen supplies, and office supplies and forms. Because of the savings direct delivery agreements afford, the consultants recommended that the county expand these agreements to other commodities, including plumbing and electrical supplies, lumber, hardware, hand tools, and auto parts. Figure 2-1 below depicts the differences between the central warehousing and direct delivery systems.

Figure 2-1




For most departments, direct delivery to users is an efficient and viable alternative to the departmental central warehouse system. However, some circumstances and commodities may continue to warrant departmental central warehousing. For example, the fire department maintains a central warehouse because of

the possibility that all station personnel may be out on a call at the time of a delivery and also because it needs to stock emergency supplies. Similarly, the probation department's Detention section, which serves a fluctuating population, and its Camps Challenger facility, which includes six camps, must maintain a central warehouse to keep available sufficient supplies such as food, toothpaste, toilet paper, and clothing.

***Materials Management
Information Systems Do Not
Provide Performance Measures***


In the departments we reviewed, we found that the materials management information systems are unique to each department and that none routinely generates the basic performance measures of turnover ratio by commodity or average inventory value. Although we were able to calculate overall turnover ratios for each department manually, we had to use information from several standard reports or request special reports. Lack of these basic performance measures prevents the departments from managing inventory effectively. The materials management information systems at the four departments also vary in sophistication. For example, the public works and the fire department appear to have fairly sophisticated systems capable of generating a variety of management reports. Public works' Inventory Control and Procurement System tracks inventory transferred from the department's central warehouse to satellite warehouses, identifies the inventory's users, and assigns the cost to a unique job number. In contrast, the Detention section of the probation department uses a disorganized, antiquated stock card system that we could not rely on for analysis of any commodities other than forms and office supplies. Also, the Main Probation inventory system does not report unit costs; therefore, the commodity values must be assigned manually. The probation department calculates the value of the inventory in the central warehouse only once a year after the staff performs a physical inventory count. Further, the Records Management and Supply section of social services is unable to reconcile its annual physical inventory to accounting records because of problems with its inventory program.


County departments do not routinely generate basic inventory performance data, which hinders effective inventory management.

The consultants also reported that each department maintains a different materials and warehousing information system. These systems are developed individually (or are modified to such a degree as to become custom systems) and do not always provide the reports and information needed to manage warehousing operations in the best manner.

Further, the inventory management systems at social services, the probation department, and the fire department do not fully integrate the materials management, purchasing, and accounting functions. Consequently, the departments duplicate effort, resulting in higher costs to the county. For example, Main Probation uses proprietary vendor software to purchase commodities on-line from three office supply agreement vendors; however, the purchasing system does not communicate with the probation department's inventory records. Procurement staff must update the inventory records manually. Similarly, at social services, the procurement unit supervisor generates by hand a purchase order that procurement staff must then enter into the system.

Departments Do Not Recognize the Full Cost of Inventory


Data on warehouse operating costs, necessary for responsible materials management, is not routinely generated.


In our review, we found that none of the departments regularly calculates, tracks, and reports warehouse cost and performance data. Although each department reviewed did provide us with warehouse operating costs, the information is not routinely generated and it required special reports. Such information is essential to responsible materials management.

Similarly, the consultants found that the departments do not recognize the costs of maintaining a storage infrastructure as part of the overall cost of goods. In most cases, the only costs that departments account for are those for salaries of individuals directly assigned to the warehouses, direct maintenance, janitorial services, utilities, and vehicles. Costs that departments generally do not acknowledge include those for rent, inventory carrying, salaries of procurement staff not directly connected to the warehouse, and user time. Departments also do not account for the costs related to users picking up orders.


Some Departments Have Improved Inventory Management

During our review, we noted several departmental actions that increased effectiveness of warehouse operations and inventory management. These accomplishments highlight the efforts of departmental staff and demonstrate the departments' commitment to improving.

A major ISD action was to close the county's central warehouse in June 1996. This move decentralized warehousing operations. The ISD projects that the closure will save \$29 million over five years and probably bring in revenue of \$9.5 million from the property's sale.



Public works and the probation department have implemented programs to decentralize warehouse operations and take advantage of direct vendor delivery.



In addition, public works is streamlining and consolidating its warehouse operations. In 1996, Rose and Associates, a consulting group, performed a departmental warehouse study. In response to the study's recommendations, this department has launched a pilot program to decentralize warehouse operations. The Rose and Associates report advocated implementing direct vendor delivery to field warehouses, reducing inventories, and consolidating warehouses. Once the pilot program finishes, a new report will recommend a course of action. Should the pilot program prove successful, the department intends gradually to convert other sites to direct delivery. The department projects annual cost savings of approximately \$340,000 when the warehouse decentralization is complete.

Also, we noted that the Camps section of the probation department currently takes advantage of direct delivery to 13 of 19 youth camps. The Camps section formerly obtained all of its commodities and food through the county's central warehouse. When the ISD warehouse closed, the section began using direct delivery to the 13 camps that have no warehouses.

Finally, we found that Main Probation orders electronically from all three agreement office supply vendors. On-line procurement eliminates the numerous paper transaction steps to obtain products, reducing clerical errors and contributing to lower administrative overhead costs. By making possible vendor delivery to users, on-line purchasing improves delivery service and reduces warehousing space and costs.

Conclusion

The county's inventory management system is inefficient and therefore costly to taxpayers. In addition, many departments store substantial amounts of excess and obsolete inventory that increases the county's warehousing and carrying costs. Also, the departments' inventory management systems do not routinely generate basic performance data. Moreover, the county continues to rely on a departmental central warehousing system to receive, store, and distribute commodities. The county could reduce costs and increase materials management efficiency by reducing the number of departmental central warehouses and taking advantage of direct delivery from

vendors whenever possible. For example, public works has launched a pilot program to decentralize warehouse operations that includes implementing direct vendor delivery, thereby reducing inventories and consolidating warehouses.

Our findings are similar to the findings of a 1996 Deloitte and Touche consultants' review of the county's warehouse operations. The consultants reported significant levels of inactive or rarely issued inventory such as forms, custom printed materials, and office supplies. The consultants determined that, in some departments, rarely issued and obsolete inventory may constitute as much as one-third of the inventory. However, despite the consultants' recommendations, the county has not yet taken significant steps to address the weaknesses in its inventory management.

Recommendations

To improve the efficiency of the county's warehousing and inventory management practices and to use public resources more effectively, the county should take the following steps:

- Regularly remove excess and obsolete items from inventory. Obsolete items should include any commodities that departments have not issued within one year of purchase.
- Set up a mechanism to facilitate inventory sharing among departments. Ideally, departments should establish joint warehouse facilities, or one department should stock items and make them available to all departments nearby.
- For all stock items, review the inventory level at which the item is reordered. A 30- to 60-day supply should be sufficient for most items.
- Have direct users of forms review these documents at least annually and salvage unused forms to reduce inventory levels. The county has agreements with vendors that will store forms and deliver as needed.
- Consider computerized generation of forms departments use.
- Take advantage of opportunities to reduce the number of central warehouses departments maintain.

- Request direct delivery from vendors to users whenever possible.
- Expand next-day delivery contracts with local vendors to include plumbing supplies, electrical supplies, lumber, hardware, hand tools, auto parts, and other commodities that are available within two days at competitive prices from reliable suppliers.
- Review and possibly enhance the departments' materials management information systems so they generate basic performance measurements and communicate directly with the departments' order entry system and with vendors. Ideally, the information system should be an "off-the-shelf" software package that the software supplier can update.
- Calculate at least quarterly the cost of operating each county warehouse and summarize costs by division and department.

By implementing the preceding recommendations, the county should see inventory turnover ratios increase for all commodities. By continuing to use turnover ratios as a management tool to measure the effectiveness of inventory management practices, the county can oversee progress toward materials management reforms.

Chapter 3

County Departments Can More Effectively Manage Their Purchases

Chapter Summary

Los Angeles County (county), which spent \$2.4 billion on goods and services during fiscal year 1996-97, needs to manage its purchases prudently to ensure responsible use of public resources. However, during our review, we found that certain county departments did not always manage their purchases effectively. In 8 of 45 transactions that we analyzed at four departments, we found flaws that contributed to consultants performing work without the required approvals and to late payments to vendors. Specifically, we found the following purchasing shortcomings:

- The Los Angeles County Fire Department (fire department) did not obtain the necessary approval before allowing consultants to incur significant costs on its behalf.
- The fire department circumvented its delegated contracting authority for one contract we reviewed.
- The Department of Public Works (public works) did not ensure that its staff had completed and obtained approval for two of five purchase orders we reviewed. As a result, the county did not pay vendors until two to five months after public works had received the goods or services.

Additionally, we found that departments do not always comply with county purchasing policies and standards. For example, the Probation Department (probation department), the Department of Public Social Services (social services), and the fire department split large purchase orders into smaller transactions, thus circumventing county purchasing standards and creating increased administrative work. Further, the probation department and social services violated purchasing standards by making purchases that exceeded authorized amounts without requesting Internal Service Department (ISD) approval, as required.



County Departments Need To Manage Purchase Orders and Contracts More Effectively

During our review, we found that county departments did not consistently manage their purchases of goods and services and thus did not control costs well. Generally, county departments purchase goods and services by issuing purchase orders or using contracts. Of the 25 purchase orders we reviewed, 7 were flawed. We also reviewed 20 contracts and found one deficient. Specifically, we found that the departments did not always seek authorization before allowing consultants to perform work or ensure that the staff had prepared documentation to allow for prompt payment.


The Fire Department Instructed Consultants To Perform Services Before Funding Was Approved

For two of the six purchase orders we reviewed at the fire department, we found that the department allowed the contractors to proceed beyond the original scope of work before it requested authorization for the additional work through change orders. In November 1996, the fire department hired two consulting firms to make recommendations on hiring and promotional practices, which, according to the fire department, were of an urgent nature because they involved racial tension within the organization. The fire department developed a detailed description of the work that the consultants would perform, stipulating that the consultants would complete a final report by January 1, 1997.


At the request of the fire department, both consultants performed work that was outside of the scope of the original purchase order. As a result, both the consultants requested higher payments than those approved in the original purchase orders. However, although the fire department instructed the consultants to perform the additional work, it did not promptly request authorization. Specifically, six weeks into the project, one consultant indicated that its costs had exceeded by approximately \$800 the original estimate of \$40,000. The fire department paid the consultant \$40,000, the amount originally agreed upon, before the consultant completed the required report. Further, because the fire department expanded the scope of the review, the consultant estimated that the cost of the remaining work would be approximately \$13,000. However, at the time this was agreed to, the fire department did not submit a change order to the ISD to increase the amount of


Two consultants performed work that was outside the scope of the original purchase order without proper approval.


the original purchase order, as required. In other words, even though the consultant had completed work up to the limit of the purchase order, the fire department, without proper authorization, allowed the consultant to continue working. In fact, by February 10, 1997, more than a month before the fire department submitted the change order, the consultant had completed the additional work and billed the fire department \$16,800. Finally, on March 17, 1997, the fire department submitted the change order to the ISD for approval. Shortly thereafter, on March 26, 1997, the final report was completed. The total amount paid to the consultant was \$56,800.



The fire department puts vendors at risk by allowing them to provide services without proper approval.



Similarly, the second consultant had submitted bills to the fire department totaling \$70,200, the amount of the original estimate, by February 1, 1997. Again, the fire department expanded the scope of work, thereby increasing costs. However, it did not submit a change order to the ISD until March 17, 1997, even though the consultant had completed the work and submitted an additional bill for \$17,100 by February 3, 1997. Payments to the second consultant totaled \$87,300. Although we found no evidence of improper payments, if the ISD had not subsequently approved the change orders, the fire department could not have approved the consultants' billings for the additional work.

In addition to the services discussed above, the fire department also improperly authorized the same consultants to perform work beyond what was included in the change orders. County purchasing standards allow departments to purchase from non-agreement vendors any goods and services up to a specified amount, usually \$5,000, without obtaining ISD approval. However, the county paid one consultant \$5,100 and paid the other \$6,100 for this additional work without the ISD's approval. Ultimately, payments to the consultants for the services ISD authorized and the additional work totaled \$62,000 and \$93,400, respectively. These amounts were 54 and 33 percent more than the original estimates.

***Ineffective Planning at the
Department of Public Works
Delayed Payments to Vendors***


In two instances, public works did not ensure that its staff completed and had approval for purchase orders before it received goods and services. When this happens, payment to the vendor may be delayed, thus straining the relationship between the county and the vendor. In one case, public works improperly issued a subpurchase order for telecommunications equipment costing \$74,400 rather than submitting a


purchase requisition to the ISD for approval. Departments use subpurchase orders when buying commodities covered by a preexisting agreement between the county and a vendor or when purchasing items less than \$5,000. After public works received the goods in August 1996, it determined that they were not covered under any existing agreement. Because public works had not obtained proper approval for the purchase, the county would not issue payment to the vendor. Once it realized the mistake, public works submitted a purchase requisition to the ISD to authorize the purchase in arrears and allow the vendor to receive payment. However, the vendor did not collect payment until approximately five months after public works had received the goods.

In another instance, public works did not promptly prepare requisitions for tree maintenance services provided by three vendors. Specifically, in January 1997, public works hired three vendors to clean up tree damage from recent windstorms. However, public works did not request authorization for payments until March and April 1997, two to three months after the vendors had provided the services. Thus, the county paid the vendors two to three months late.

The Fire Department Circumvented Its Delegated Contracting Authority

By using various funding mechanisms to pay for a construction project, the fire department circumvented its delegated contracting authority and spent more money than the county board of supervisors (board) had approved. In January 1996, the board approved the fire department's request to spend \$150,000 for the construction of a firestation garage on Catalina Island. In March 1996, the fire department received initial bids from seven contractors. The bids ranged from \$255,000 to \$413,000, well over the amount authorized for the project. The fire department subsequently modified the scope of work and solicited a second set of bids, indicating in its correspondence to the contractors that the funding for the project was \$150,000. In August 1996, the fire department awarded a contract totaling \$146,700. Nonetheless, the fire department will ultimately spend approximately \$212,700 to complete this project, \$62,700 more than the board authorized.




To pay for additional construction costs, the fire department issued unrelated purchase orders and charged an existing maintenance agreement.


During construction of the garage, the fire department requested that the contractor perform additional work outside of the modified scope of work. However, because the fire department did not want to request additional funding from the board, it used alternative methods to pay for the additional work rather than charge the costs to the contract. For instance, the fire

department issued new purchase orders to other vendors to pay for certain costs the contractor incurred in exchange for the contractor performing additional work. The fire department should have charged these costs against the contract because the charges related directly to the construction project. For example, the fire department issued additional purchase orders totaling \$14,200 to pay for refuse, sanitation, and transportation costs the contractor incurred. In return, the contractor agreed that it would, among other tasks, install a fire sprinkler system and upgrade the electrical work.

Another method the fire department used to pay for the additional work was to charge costs to an existing maintenance agreement it had with the contractor. Specifically, the fire department used the maintenance agreement to pay approximately \$19,700 for the contractor to remove and replace a driveway and install underground electrical lines.

Because difficulties the contractor experienced prevented it from completing the work, the fire department paid the contractor only \$118,800 under the original contract, \$27,900 less than the contracted amount. However, using the separate purchase orders, the fire department paid an additional \$14,200 for refuse, sanitation, and transportation costs the contractor incurred. Further, the fire department also paid the same contractor \$19,700 under the existing maintenance contract. Therefore, the fire department paid a total of \$152,700. Although the contractor did not complete the work, the fire department paid only for the work completed.


The fire department estimates it will spend \$62,700 more than the board of supervisors allowed for the garage.


The fire department has hired a second contractor to complete the work. In addition to the \$27,900 it will pay the second contractor under the terms of the original contract, the fire department estimates that it will have to pay an additional \$32,000. As a result, the total cost of constructing the garage will be approximately \$212,700, which is \$62,700 more than the board approved.

Some County Departments Exceeded Their Delegated Purchasing Authority

When reviewing the detailed purchase order logs for fiscal year 1996-97 at three of the four county departments we visited, we found that two departments had exceeded their delegated purchasing authority, the maximum amount they can spend on single purchase orders for nonagreement goods and services. Because the fire department's accounting system included only summary information for some transactions, we did not attempt

to review the purchase order logs. Our review disclosed that the probation department and social services made purchases that exceeded their delegated authority without obtaining the ISD's approval, as required.

In Chapter 1 of this report, we recommend that the county increase departments' delegated purchasing authority from \$5,000 to \$15,000. However, until the county decides to do so, its departments need to comply with current purchasing policies.


The probation department exceeded its delegated purchasing authority in 41 instances.

For fiscal year 1996-97, the probation department's delegated authority for purchases of goods was \$5,000. However, we found that the probation department consistently purchased goods in excess of \$5,000 without obtaining ISD approval, as required. Specifically, for fiscal year 1996-97, we noted 41 instances in which the probation department exceeded its delegated authority. For example, in one instance, the probation department did not obtain the ISD's approval to purchase clothing for approximately \$33,000, an amount \$28,000 in excess of its delegated purchasing authority. For the remaining transactions, the amounts by which it exceeded its delegated authority ranged from approximately \$91 to \$12,600. Similarly, we noted two instances at social services in which it exceeded its delegated authority by \$250 and \$3,200.

***Departments Circumvented
County Purchasing Policies by
Splitting Purchase Orders***

Our review also revealed that social services, the probation department, and the fire department split purchase orders so that they could cover individual purchases with their delegated purchasing authority. As explained earlier, a department may purchase goods and services not covered by an existing agreement between the county and a vendor up to the department's delegated purchasing authority, which is usually \$5,000, without obtaining the ISD's approval. Purchases totaling more than this must receive ISD approval. The county's purchasing standards specifically prohibit splitting or fragmenting purchases to bring individual acquisitions within a department's delegated purchasing authority. In addition, such an approach to obtaining goods and services wastes public resources because it requires additional administrative time and effort.

—◆—
By making several smaller purchases with multiple purchase orders, social services bought equipment without ISD's approval.
—◆—

During our review of social services' purchase order logs for fiscal year 1996-97, we identified six separate instances in which social services split purchase orders to avoid seeking ISD approval. For example, on March 14, 1997, social services issued seven separate purchase orders to a single vendor for audiovisual equipment totaling \$20,300. However, by splitting the purchase into several smaller purchases, each within its delegated authority, social services was able to buy the equipment without obtaining the ISD's approval. Similarly, on July 11, 1996, social services issued five purchase orders to a vendor for signature plates. Again, although the total cost was \$13,300, social services avoided going to the ISD for approval by splitting the purchase into five smaller transactions.

We also noted two instances of split purchase orders at the probation department. For example, on July 9, 1996, the probation department issued 14 separate purchase orders to buy household items from the same vendor. Although the cost listed on each purchase order was within the department's delegated purchase authority, the 14 purchase orders totaled approximately \$21,000.

Finally, at the fire department, we noted one instance of a split purchase order. Specifically, the fire department hired a consultant to review the fees it charges for hazardous materials inspections. However, rather than issue a single purchase order for the consultant's services, the fire department issued two purchase orders for \$5,000 and \$4,000, respectively.

In addition to bypassing county standards, splitting purchase orders represents an inefficient use of public resources because departmental officials have to approve each purchase order separately. Further, upon the departments' receipt of the goods, employees have to approve separate invoices for payment. Finally, splitting purchase orders into several transactions causes the Auditor-Controller's Office, which pays vendors on behalf of county departments, to process and issue several payments to each vendor. If departments group transactions by vendor, only one payment to each vendor is necessary.

Conclusion

The four county departments we reviewed did not consistently protect public resources by adequately managing purchases and by complying with county purchasing policies. Specifically, the fire department may have put consultants at risk of not being paid by instructing them to perform work before obtaining approval. Additionally, public works did not always ensure that it executed purchase orders to pay vendors promptly.

In one instance, the fire department bypassed its delegated contracting authority. Some departments are also circumventing county policies and incurring unnecessary administrative costs by splitting purchase orders. Finally, some departments are purchasing goods and services in excess of their delegated purchasing authority without obtaining ISD approval, as required.

Recommendations

To use county funds as economically as possible, the departments should manage purchases carefully. Specifically, the departments should do the following:

- Obtain required approvals before allowing consultants to perform work on their behalf.
- Ensure that staff completes purchase orders accurately and promptly.

Moreover, the ISD should emphasize to departments the county's policies on splitting purchase orders and exceeding delegated purchasing authority.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



KURT R. SJOBERG
State Auditor

Date: November 5, 1997

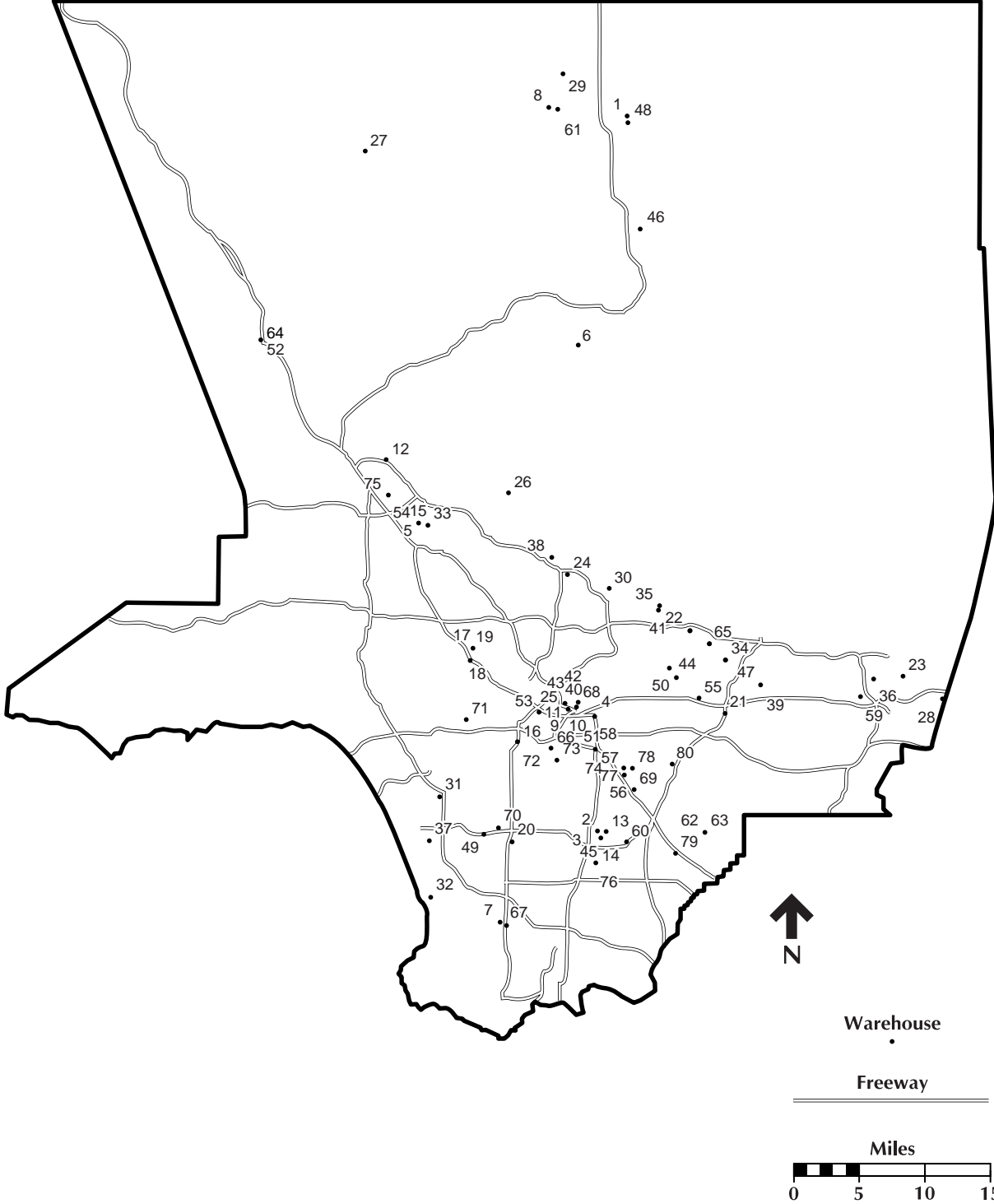
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Appendix

Location of Los Angeles County Warehouse and Storage Facilities of Over 1,000 Square Feet

The map and accompanying descriptions on the following pages show the location of the county's warehouses and storage facilities of over 1,000 square feet. Based on the close proximity of many of the warehouses, if the county expands its use of direct delivery and eliminates excess or obsolete inventory, thereby reducing the need for warehouse space, it should be feasible for the county to consolidate some of its warehouses.

**Location of Los Angeles County Warehouse and Storage Facilities
of Over 1,000 Square Feet**



City	Proprietor	Net Sq. Ft.	Map No.	City	Proprietor	Net Sq. Ft.	Map No.
Acton	HS-Antelope Valley Rehab	2,756	6	Los Angeles	Museum of Art	23,947	71
Altadena	Pub Works-Fleet Mgt Group	3,060	30	Los Angeles	Natural History Museum	27,099	16
Arcadia	Parks & Rec-Administration	1,396	22	Los Angeles	Natural History Museum	9,500	72
Baldwin Park	Parks & Rec-Administration	18,009	21	Los Angeles	Pks & Rec-Administration	13,595	20
Baldwin Park	Pub Works-Operational SVC	2,376	39	Los Angeles	Probation-Administration	9,851	74
Baldwin Park	Pub Works-Road Maint	4,680	47	Los Angeles	Probation-Detention	3,136	25
Castaic	Sheriff-PitchessDetCtr	18,835	52	Los Angeles	Pub Works-Operational SVC	25,025	40
Castaic	Sheriff-PitchessDetCtr	1,781	64	Los Angeles	Pub Works-Operational SVC	19,367	42
Commerce	ISD Admin & Finance Svc	11,680	57	Los Angeles	Pub Works-Operational SVC	53,646	43
Commerce	Public Social Services	58,537	77	Los Angeles	Sheriff-Custody/Court Svc	7,963	51
Downey	Animal Care & Control	1,265	3	Monrovia	Chief Admin Office		65
Downey	HS-Rancho Los Amigos MC	53,155	13	Montebello	HS Pub Health Pgms & Svcs	1,555	69
Downey	HS-Rancho Los Amigos MC	7,816	14	Montebello	Registrar-Recrder/Co Clerk	23,996	78
Downey	Pub Works-Road Maint	1,037	45	Norwalk	Sheriff-Admin/Enforcement	1,670	79
Downey	Probation-Administration	4,745	60	Pacoima	Fire Department	15,271	54
El Monte	HS Personal Health Svcs	3,369	55	Pacoima	Fire Department	12,250	5
El Segundo	Pub Works-Flood Maint	1,710	37	Pacoima	ISD Info Technology Svc	9,136	15
Hawthorne	Public Library	6,132	49	Palmdale	Pub Works-Road Maint	2,430	46
Hollywood	Parks & Rec-Administration	1,625	17	Paramount	Public Library	12,496	76
Hollywood	Parks & Rec-Administration	4,355	18	Pasadena	Pub Works-Flood Maint	6,866	35
Hollywood	Parks & Rec-Administration	1,067	19	Pasadena	Pub Works-Operational SVC	1,790	41
Irwindale	Pub Works-Flood Maint	9,872	34	Pico Rivera	Treasurer & Tax Collector	62,180	80
La Canada	Parks & Rec-Administration	1,315	24	Pomona	Parks & Rec-Administration	1,176	23
La Crescenta	Pub Works-Flood Maint	1,368	38	Redondo Bch	Pub Works-Flood Maint	1,938	32
Lake Hughes	Probation-Residential	1,314	27	San Dimas	Parks & Rec-Administration	1,821	59
Lancaster	AG COMM/Wts & Measures	1,470	1	San Dimas	Pub Works-Flood Maint	1,037	36
Lancaster	HS-High Desert Hospital	26,434	8	San Fernando	Public Defender	4,190	75
Lancaster	Pub Works-Aviation	14,703	29	South Gate	AG COMM/Wts & Measures	19,371	2
Lancaster	Pub Works-Waterworks	3,620	48	Sun Valley	Pub Works-Flood Maint	11,855	33
Lancaster	Probation-Residential	17,530	61	Sylmar	HS-Olive VW/UCLA Med Ctr	125,347	12
LaVerne	Pub Works-Aviation	77,490	28	Temple City	Pub Works-Road Maint	1,625	44
Los Angeles	Chief Admin Office	67,595	53	Temple City	Sheriff-Admin/Enforcement	3,550	50
Los Angeles	DC & FS Administration	5,558	66	Torrance	HS-Harbor/UCLA Med Ctr	6,643	7
Los Angeles	Fire Department	3,849	4	Torrance	HS Harbor/UCLA Med Ctr	7,320	67
Los Angeles	HS-LA County+USC Med Ctr	75,300	68	Tujunga	Probation-Residential	1,216	26
Los Angeles	HS-LA County+USC Med Ctr	26,384	9	Vernon	Natural History Museum	15,932	73
Los Angeles	HS-LA County+USC Med Ctr	31,092	10	Westchester	Pub Works-Flood Maint	4,414	31
Los Angeles	HS-LA County+USC Med Ctr	24,511	11	Whittier	Sheriff-Admin/Enforcement	54,044	62
Los Angeles	ISD Admin & Finance Svc	280,590	56	Whittier	Sheriff-Admin/Enforcement	43,714	63
Los Angeles	ISD Admin & Finance Svc	11,140	58				
Los Angeles	ISD Purch & Central Svc	3,636	70				

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Response to the report provided as text only

County of Los Angeles
Chief Administrative Office
713 Kenneth Hahn Hall of Administration
Los Angeles, California 90012
(213) 974-1101
David E. Janssen
Chief Administrative Officer

October 30, 1997

Kurt R. Sjoberg
State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

RESPONSE TO DRAFT STATE AUDIT REPORT ON COUNTY PURCHASING AND WAREHOUSING PRACTICES

Thank you for the opportunity to comment on the draft version of the audit referenced above, conducted pursuant to Chapter 518, Statutes of 1995. In this audit report titled, "Los Angeles County: Departments Can Improve Purchasing and Warehousing Practices," your staff focused on County purchasing and contracting practices as well as warehousing operations. You made recommendations to reduce purchasing costs through better monitoring of department purchases and by streamlining the procurement process through increased delegation of authority to departments. In addition, you identified possible savings through improved inventory management and consolidation of warehouses. Finally, you noted some departments were not complying with County purchasing and contracting practices and recommended increased monitoring and training.

In general, we agree with your recommendations. Indeed, the Internal Services Department (ISD) and Auditor-Controller have been evaluating a computer system that will automate much of the existing paper-based purchasing processes, as well as gather purchasing data that will assist ISD in identifying purchasing trends that may lead to the further consolidation of the County's purchases and more favorable prices for goods. In addition, on August 5, 1997, the Board of Supervisors directed the Quality and Productivity Commission to examine County inventory and warehousing practices and to make recommendations to improve management of these resources. Finally, the Auditor-Controller has recently expanded its departmental compliance reviews to include compliance with Board purchasing and contracting policies.

Kurt R. Sjoberg
October 30, 1997
Page 2

Thank you once again for the opportunity to comment on the draft.

Questions or requests for additional information regarding implementation status will be coordinated by the Auditor-Controller's Office; please contact Tyler McCauley, Assistant Auditor-Controller, at (213) 974-8303.

Sincerely,

DAVID E. JANSSEN
Chief Administrative Officer

ALAN SASAKI
Auditor-Controller

DEJ:AS
mmg24

c: Each Supervisor
Director, Internal Services
Chair, Quality and Productivity Commission

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps